DOCUMENT RESUME

ED 399 904 HE 029 540

TITLE	Abuses in Federal Student Grant Programs: Proprietary School Abuses. Hearing before the Permanent Subcommittee on Investigations of the Committee on Governmental Affairs. United States Senate, One Hundred Fourth Congress, First Session.
INSTITUTION	Congress of the U.S., Washington, D.C. Senate Committee on Governmental Affairs.
REPORT NO	ISBN-0-16-052791-0; Senate-Hrg-104-477
PUB DATE	12 Jul 95
NOTE	256p.; Contains pages of small print that may not reproduce clearly.
AVAILABLE FROM	U.S. Government Printing Office, Superintendent of Documents, Congressional Sales Office, Washington, DC 20402.
PUB TYPE	Legal/Legislative/Regulatory Materials (090)
EDRS PRICE	MF01/PC11 Plus Postage.
DESCRIPTORS	*Federal Aid; Federal Programs; Financial Aid Applicants; Grants; Hearings; Hispanic Americans; Loan Repayment; Postsecondary Education; *Proprietary Schools; Student Costs; *Student Financial Aid; Vocational Education; Vocational Schools
IDENTIFIERS	Congress 104th; *Fraud; *Pell Grant Program

ABSTRACT

The purpose of this hearing was to probe a pattern of fraud and abuse in the Pell Grant Program for postsecondary students, focusing specifically on the IADE American Schools, a for-profit vocational school with campuses in the Los Angeles (California) area and serving primarily Hispanic students. In his opening remarks Senator Roth detailed a history of prior abuses of the program and lax oversight by the Department of Education. Senator Nunn, after summarizing a five-year series of hearings, reports, and recommendations, testified that a year-long investigation of the IADE schools had uncovered serious misconduct, abuses, and possibly fraudulent practices. He charged that the Department was not only incapable of preventing a fraudulent institution from participating in student aid programs but was also unable to detect or pursue such fraudulent activities. Following the senators' opening statements, the Subcommittee team investigating IADE schools reported its findings. David Longanecker, Assistant Secretary for Postsecondary Education, then reviewed the Department's procedures and policies, stating that oversight was being improved. The final testimony was a report from the U.S. General Accounting Office assessing the Department's effectiveness in using student aid data to ensure compliance and prevent abuses. An appendix contains the texts of the witnesses' prepared statements. 56 exhibit statements are listed separately. (CH)

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S. Hrg. 104-477

ABUSES IN FEDERAL STUDENT GRANT PROGRAMS
PROPRIETARY SCHOOL ABUSES

ED 399 904

HEARING

BEFORE THE

PERMANENT
SUBCOMMITTEE ON INVESTIGATIONS
OF THE

COMMITTEE ON
GOVERNMENTAL AFFAIRS
UNITED STATES SENATE

ONE HUNDRED FOURTH CONGRESS

FIRST SESSION

JULY 12, 1995

Printed for the use of the Committee on Governmental Affairs

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92-498 CC WASHINGTON : 1996

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CONTENTS

	Page
Opening statements:	
Senator Roth	1
Senator Nunn	3

WITNESSES

WEDNESDAY, JULY 12, 1995

Alan Edelman, Counsel to the Minority, and R. Mark Webster, Staff Investigator to the Minority, Permanent Subcommittee on Investigations, U.S. Senate	6
David A. Longanecker, Assistant Secretary for Postsecondary Education, U.S. Department of Education; accompanied by Donald R. Wurtz, Chief Financial Officer	33
John P. Higgins, Jr., Acting Inspector General, U.S. Department of Education	43
Cornelia Blanchette, Associate Director, Education and Employment Issues, Health, Education, and Human Services Division, U.S. General Accounting Office; accompanied by Joseph J. Eglin, Assistant Director	50

ALPHABETICAL LIST OF WITNESSES

Blanchette, Cornelia:	
Testimony	50
Prepared statement	139
Edelman, Alan	
Testimony	6
Prepared statement	63
Higgins, John P. Jr.:	
Testimony	43
Prepared statement	126
Longanecker, David A.:	
Testimony	33
Prepared statement	114
Webster, R. Mark:	
Testimony	6
Prepared statement	63

APPENDIX

Prepared statements of witnesses in order of appearance	63

EXHIBIT LIST

	Page
1. Statement for the Record of Representative Bart Gordon (D–TN), dated July 11, 1995	145
2. Letter for the Record of Barbara B. Gregg, Director, Office of Consumer Affairs, Montgomery Country Government, Rockville, Maryland, dated July 28, 1995	148
3. Letter for the Record of Donald J. Nolan, Deputy Commissioner for Higher Education and the Professions, New York State Education Department, dated July 18, 1995	151
4. Memorandum from Ken Williams, Director of Financial Aid, IADE, dated July 14, 1994, to Abraham, Sergio, Bernardo and Alex Stofenmacher and Gonzalo Freixes, regarding "Current Refunds"	154
5. a Video Deposition conducted by the Permanent Subcommittee on Investigations on July 5, 1995 of Ken Williams, Director of Financial Aid, IADE	*
b Excerpts of Video Deposition conducted by the Permanent Subcommittee on Investigations on July 5, 1995 of Ken Williams, Director of Financial Aid, IADE. (Excerpts presented at July 12, 1995 Permanent Subcommittee on Investigations' hearing.)	*
c Transcript of excerpts of Video Deposition conducted by the Permanent Subcommittee on Investigations on July 5, 1995 of Ken Williams, Director of Financial Aid, IADE. (Excerpts presented at July 12, 1995 Permanent Subcommittee on Investigations' hearing.)	157
6. Memorandum to Mark Webster, Investigator, Permanent Subcommittee on Investigations, dated June 1, 1995, from Arnaldo Sanchez, regarding 1993 ACCET inspection of IADE Oxnard campus	162
7. Complaint for Damages, *Maria McFarlane* vs. *IADE American Schools, et al.*, Superior Court of California, County of Los Angeles, Central District	*
8. Affidavit of Jorge E. Shepherd, made to the Permanent Subcommittee on Investigations, dated December 21, 1994, regarding IADE	163
9. Affidavit of Augusto V. Guerra, made to the Permanent Subcommittee on Investigations, dated December 21, 1994, regarding IADE	167
10. Selected Corporate charge account statements for IADE American Schools, 1991–1994	*
11. Various signed vehicle lease agreements for IADE American Schools, 1991–1994	*
12. Selected documents pertaining to U.S. Department of Education determination of eligibility for IADE American Schools, Southgate, California, 1989–1990	*
13. a Letter to IADE American Schools, dated September 28, 1992, from the U.S. Department of Education, transferring IADE American Schools to reimbursement system of payment	*
b Letter to IADE American Schools, dated January 26, 1993, from the U.S. Department of Education, transferring IADE American Schools from reimbursement system of payment to the advance funding system	*
c Letter to U.S. Department of Education, dated June 28, 1994, from IADE American Schools, regarding "Consent Agreement for the Return of IADE American Schools to Advance Payment Status"	*
14. Letter to Ken Williams, Corporate Director of Student Financial Aid, IADE American Schools, dated February 11, 1992, from U.S. Department of Education, regarding entrance conference for March 1992 Department of Education Audit	*
15. a U.S. Department of Education September/October 1992 Program Review Report of IADE American Schools	*

Page

b. Correspondence between IADE American Schools and the U.S. Department of Education, dated November 1992–March 1994, regarding September/October 1992 Program Review Report ..... *

16. a. Draft Audit Report of IADE American Schools for the audit period July 1989 through March 1992, prepared by the U.S. Department of Education Office of Inspector General ..... *

b. Final Audit Report of IADE American Schools for the audit period July 1989 through March 1992, prepared by the U.S. Department of Education Office of Inspector General ..... *

c. SEALED EXHIBIT: Report of Investigation of IADE American Schools, dated July 9, 1993, prepared by U.S. Department of Education Office of Inspector General ..... *

17. Summary Listing of Investigative Management and Policy Changes Implemented Since 1992, prepared by the U.S. Department of Education Office of Inspector General ..... *

18. U.S. Department of Education Office of Inspector General Audits:

a. Financial Analysis Certification Process Not Adequate to Protect Students and Government (Audit Control Number 11–80160), September 1989 ..... *

b. Accrediting Agency Recognition Process Does Not Serve as an Effective Control in Determining the Reliability of Agencies that Accredit Numerous Problem Schools (Audit Control Number 11–90050), February 1991 ..... *

c. Administrative Certification Process Does Not Adequately Assure that All Schools are Capable of Administering Title IV Funds (Audit Control Number 11–00012), March 1991 ..... *

d. The Institutional Eligibility Process Does Not Provide Adequate Assurance that Only Eligible Schools Participate in the Title IV Programs (Audit Control Number 11–90040), March 1991 ..... *

19. Draft Financial Statement Analysis of IADE Corporation for the fiscal years 1990–1992, prepared by Oscar Sendowsky (FY 1990), BDO Seidman (FY 1991), and Lowenthal, Goldring & Co. (FY 1992) ..... *

20. Letter to IADE American Schools, dated August 25, 1994, from U.S. Department of Education, regarding final audit determination of audit report for period July 1, 1989 through June 20, 1991 ..... *

21. Letter to U. S. Department of Education, dated July 5, 1995, from IADE American Schools, regarding May 19, 1995 Final Audit Determination for IADE American Schools ..... *

22. Department of Education Office of Inspector General Draft Report, dated June 15, 1995, entitled *The Department Should Consider State Workforce Development Initiatives in its Efforts to Reform Title IV Funded Job Training* ..... *

23. Correspondence between Permanent Subcommittee on Investigations and Mary Gibbons, Esquire, counsel to IADE American Schools, dated June 20, 1995 and July 3, 1995, regarding appearance of Bernardo Stofenmacher before the Subcommittee pursuant to Subcommittee subpoena 171

24. a. SEALED EXHIBIT: Letter to the Permanent Subcommittee on Investigations from confidential source regarding IADE American Schools *

b. SEALED EXHIBIT: Reports from Dunn & Bradstreet Information Services relating to IADE American Schools ..... *

25. Proposed Consumer and Student Protection Legislation Regarding Unpaid Refunds to Student, prepared by California Council for Private Postsecondary and Vocational Education ..... *

26. Minutes of August 10, 1995 meeting of California Council for Private Postsecondary and Vocational Education (CPPVE), U.S. Department of Education Institutional Review Branch, and U.S. Department of Education Office of Inspector General ..... *

27. Letter to Roger Williams, President, Accrediting Council for Continuing Education & Training (ACCET), dated March 2, 1995, from Abraham Stofenmacher, President, IADE American Schools, regarding February 3, 1995 ACCET team visit exit interview 174

28. Statement for the Record of Deanne Loonin, Staff Attorney, Bet Tzedek Legal Services, Los Angeles, California, dated May 24, 1995 179

Page

29. Letter to Dan Gelber, Chief Counsel to the Minority, Permanent Subcommittee on Investigations, dated June 5, 1995, from David A. Longanecker, Assistant Secretary of Education for Postsecondary Education, regarding activities of the Office of Postsecondary Education *
30. Correspondence between R. Mark Webster, Investigator, Permanent Subcommittee on Investigations, and Eliot R. Long, Vice President, Wonderlic Personnel Test, Inc., dated August 10 and 19, 1994, regarding administration of Wonderlic Scholastic Level Exam *
31. Correspondence between Wonderlic Personnel Test, Inc. and Gladys Canovil, IADE American Schools, dated December 23 and 29, 1994, regarding termination and/or probation of independent test administrator's registration for various IADE employees *
32. U.S. Department of Education's Cash on Hand Reconciliation Spreadsheet per Fiscal Year for IADE American Schools, covering period 7/1/74–6/30/95 183
33. Federal Cash Transaction Reports for IADE American Schools, covering periods 1/1/92–3/31/92 and 10/1/93–1/31/95 *
34. Letter, with attachments, to R. Mark Webster, Investigator, Permanent Subcommittee on Investigations, dated June 26, 1995, from Jeanne B. Saunders, Director, Application and Pell Processing Systems Division, U.S. Department of Education, regarding schools with Pell Grant funding equal to or greater than IADE American Schools for the years 1989–1995 (attachments retained in the files of the Subcommittee) 193
35. Letter, with attachments, to R. Mark Webster, Investigator, Permanent Subcommittee on Investigations, dated June 16, 1995, from Jeanne B. Saunders, Director, Application and Pell Processing Systems Division, U.S. Department of Education, regarding Pell Grant authorizations by school type and state for the years 1992–1995 *
36. Letter, with attachments, to R. Mark Webster, Investigator, Permanent Subcommittee on Investigations, dated July 10, 1995, from Jeanne B. Saunders, Director, Application and Pell Processing Systems Division, U.S. Department of Education, regarding Pell Grant Data for beauty and cosmetology schools for the year 1994–95 *
37. Letter to R. Mark Webster, Investigator, Permanent Subcommittee on Investigations, dated May 16, 1995, from Mary Gibbons, Esq., attorney for IADE American Schools, regarding deposition of Bernardo Stofenmacher pursuant to Subcommittee subpoena 195
38. Letter to Permanent Subcommittee on Investigations, dated July 11, 1995, from Mark Karalla, M.D., Tarzana, California, regarding inability of Bernardo Stofenmacher to travel due to medical condition of his spouse 197
39. Letter to Senator Sam Nunn from David A. Longanecker, Assistant Secretary of Education for Postsecondary Education, regarding additional material to be included in Subcommittee's hearing record 199
40. Report, U.S. General Accounting Office, *Student Financial Aid: Data Not Fully Utilized to Identify Inappropriately Awarded Loans and Grants* (GAO/HEHS–95–89), July 1995 *
41. Responses of John P. Higgins, Jr., Acting Inspector General, U.S. Department of Education, to Permanent Subcommittee on Investigations' additional questions for the record 205
42. Responses of David A. Longanecker, Assistant Secretary for Post-secondary Education, U.S. Department of Education, to Permanent Subcommittee on Investigations' additional questions for the record 211
43. Memorandum to Permanent Subcommittee on Investigations, dated July 12, 1995, from Rose Miller, Administrator, Georgia State Postsecondary Review Entity, regarding administration of Title IV programs with particular reference to Pell Grants and the State Postsecondary Review Program 228
44. Letter to Senator William V. Roth, Jr., dated July 8, 1995, from Richard R. Harvey, Executive Director, Patricia Stevens College, regarding evaluation of quality of proprietary school education 229
45. Letter to Mary E. Kurutz, New York State Education Department, dated July 7, 1995, from Kenneth Waters, Chief, State Liaison Branch, Accreditation and State Liaison Division, U.S. Department of Education, regarding present referral status of certain postsecondary institutions in New York State *

Page

46. Letter to Geneva Coombs, Acting Chief, Default Management Section, U.S. Department of Education, dated October 6, 1993, from Abraham Stofenmacher, President, IADE American Schools, regarding IADE's voluntary withdrawal from Federal Family Education Loan Programs 236
47. SEALED EXHIBIT: Various internal Department of Education documents regarding actions taken IADE American Schools, covering period June 1992–April 1995 *
48. SEALED EXHIBIT: Various documents related to a *qui tam* action filed against IADE American Schools *
49. a. Reviewed Financial Statements of IADE American Schools for the period ending January 31, 1991, prepared by Oscar Sendowsky, CPA *
b. Reviewed Financial Statements of IADE American Schools for the period ending January 31, 1992, prepared by BDO Seidman *
c. Reviewed Financial Statements of IADE American Schools for the period ending December 31, 1993, prepared by Lowenthal, Goldring & Co., CPA *
d. Financial Statements of IADE American Schools for the period ending January 31, 1993, revised July 25, 1993 *
e. Report and Financial Statements of IADE American Schools for the twelve months ending December 31, 1993 and the twelve months ending January 31, 1993, prepared by Lowenthal, Goldring & Co., CPA *
50. a. Independent Audit of SFA Modified Statement of Cash Receipts and Disbursements of IADE American Schools for the years ended June 30, 1991 and June 30, 1990, prepared by Barry Glasser, CPA *
b. IADE American Schools' Corrective Action Plan and Response to Biennial Audit for the years ended June 30, 1991 and June 30, 1990 *
51. SEALED EXHIBIT: Summary of Review of Financial Documents of IADE American Schools as of September 29, 1994, prepared by U.S. General Accounting Office *
52. Selected documents pertaining to the accreditation of IADE American Schools by the Accrediting Council for Continuing Education and Training (ACCET), for the period September 1989–March 1995 *
53. Selected documents pertaining to audits of IADE American Schools conducted by the California Council for Private Postsecondary and Vocational Education (CCPPVE), for the period May 1993–January 1995 *
54. Statement for the Record of Les Cochran, Manager, Consumer and Student Protection, California Council for Private Postsecondary and Vocational Education (CCPPVE), dated June 5, 1995 238
55. SEALED EXHIBIT: Selected student records from IADE American Schools pertaining to no-show students *
56. SEALED EXHIBIT: Selected financial documents pertaining to corporate officers of IADE American Schools *

* Retained in the files of the Subcommittee

ABUSES IN FEDERAL STUDENT GRANT PROGRAMS PROPRIETARY SCHOOL ABUSES

WEDNESDAY, JULY 12, 1995

U.S. SENATE,
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS,
OF THE COMMITTEE ON GOVERNMENTAL AFFAIRS,
Washington, DC.

The Subcommittee met, pursuant to notice, at 9:35 a.m., in room SD–342, Dirksen Senate Office Building, Hon. William V. Roth, Jr., Chairman of the Subcommittee, presiding.

Present: Senators Roth and Nunn.

Staff Present: Daniel Gelber, Minority Chief Counsel; John Sopko, Minority Deputy Counsel; Mary Robertson, Assistant Chief Clerk; Alan Edelman, Minority Counsel; R. Mark Webster, Minority Investigator; Scott Newton, Minority Investigator; Harold Damelin, Chief Counsel; Carla Martin, Chief Clerk; Christopher Greer, Investigator; Sue Horner, Librarian; Jack Cobb, Counsel; Michael Bopp, Counsel; Lee Mitchell, Minority Intern; Deval R. Karina Zaveri, Minority Intern; Brian Dettelbach (Senator Glenn); Cathy O'Brien (Senator Nunn); Mary Ailes; Ariadne Allen; Tim Dudderer; Jim Taylor; and Richard Keenan.

OPENING STATEMENT OF SENATOR ROTH

Chairman ROTH. The Subcommittee will please be in order.

This morning, the Permanent Subcommittee on Investigations continues to probe the problems that persist in the Department of Education's Pell Grant program. We will hear today about the fraud and abuse that continue to plague one of our Government's most well-intentioned programs. I commend the distinguished ranking member, Senator Nunn, and his staff for their fine efforts in exposing these problems.

Through previous hearings, this Subcommittee has revealed that unscrupulous individuals have defrauded various Federal student aid programs literally of millions and millions of dollars. By clever schemes and lax Federal enforcement policies, these crooks have been able to manipulate the system and steal our money.

It was only 2 years ago that this Subcommittee convened to examine Pell Grant abuses in certain Yeshiva schools in New York City. The fraud that was discovered was startling, but just as startling was the ineffective oversight by the Department of Education that allowed the fraud to continue. At that time, we were assured by representatives from the Department of Education that necessary steps were being taken to curb the abuses in the Pell Grant program. While I do not doubt that certain good-faith efforts have

been made in this regard, our presence here today indicates that the Department has not done enough.

This morning, we will revisit the area of Pell Grant abuses by focusing specifically on the actions of IADE American Schools. IADE is a for-profit vocational school that has campuses in the L.A. area, and as we will learn today, the owners of the school, who are not even citizens of the United States, defrauded the Pell Grant program of millions of dollars. They managed to do this even though the Department of Education audited the school in 1992 to ensure that it was playing by the rules of the game. Remarkably, the Department gave IADE a clean bill of health and never prevented the school from receiving Pell Grant money. The Department's failure to uncover the ongoing fraudulent activities at IADE cost taxpayers millions of dollars.

This Subcommittee has illuminated many instances of abuse in Federal student aid programs, but we will never see true progress until the Department's gatekeeping and enforcement mechanisms are improved. In our past hearings on student aid, we remarked that because of ineffectual oversight, aspects of the Federal Government's student aid programs have appeared to be policed by little more than an honor system.

This hearing serves to remind us of the old adage that there is no honor among thieves, even among thieves who hold themselves out as educators and administrators. The question I want the Department to answer for us today is why does the Department seem to have so much difficulty catching them?

Congress must try to ensure that the Department of Education diligently roots out unscrupulous individuals who masquerade as educators in order to defraud our student aid programs. This is the only way we can be sure that every dollar of Federal student aid goes to legitimate students who seek an education from legitimate educators. Unfortunately, it seems clear that the Department has not succeeded in this task as well as it should have.

The Department's problems stem at least in part from its own managerial structure. The Department has unwisely divided the task of awarding and administering Pell Grants among three different units within its own Office of Postsecondary Education. This arrangement makes it impossible to pinpoint who is responsible for overseeing the effectiveness of the program. It would be far better if the Department clarified who holds responsibility for the program because the buck must stop somewhere. As Congress has said repeatedly, when Government fails to maintain accountability, Government's effectiveness is invariably compromised.

Today's hearing will reveal problems which persist in our Pell Grant program. It is my hope that the Subcommittee can continue to work with the Department to correct these problems, thus ensuring that the future of our students and the dollars of our taxpayers are adequately protected.

Unfortunately, my role in the regulatory reform bill which is currently on the Senate floor will cause me to miss much of today's hearing. Senator Nunn, since you have taken the lead on this most important investigation, I would ask you to Chair the hearing in my absence.

OPENING STATEMENT OF SENATOR NUNN

Senator NUNN [presiding]. Thank you very much, Mr. Chairman, and we appreciate all of your splendid cooperation and that of your staff.

I will apologize to all who are listening today about my voice. I have had a summer cold go directly to my throat. I do not feel as bad as I sound, if that makes you any more comfortable.

Five years ago, Mr. Chairman, the Subcommittee began a series of hearings examining the operation of the Federal guaranteed student loan program. Those hearings uncovered widespread fraud and abuse on the part of many key participants in the loan program, and also revealed serious deficiencies in the role played by the Department of Education in administering and overseeing that program.

As a result of those hearings, the Subcommittee issued a report in 1991 entitled "Abuses in Federal Student Aid Programs," which was highly critical of almost every aspect of the administration and operation of the loan program. The report contained over 25 separate recommendations for reform, many of which were ultimately incorporated into the 1992 amendments to the Higher Education Act.

In 1993, the Subcommittee held its first hearing on the Federal Pell Grant program. That hearing revealed that the Pell Grant program was being undermined by many of the same systemic weaknesses that plagued the student loan program, and that those weaknesses undercut the ability of the Government to deter, detect, and pursue fraud and abuse by program participants. In particular, the Subcommittee discovered that the Department's gatekeeping and program review functions were woefully inadequate and ineffective.

These inadequacies were particularly troublesome with respect to the Pell Grant program because apart from strong and continuous oversight, there are not the types of indicators in the Pell program as there are in the loan program to alert one to the possibility of ongoing abuse. For instance, when students have no repayment obligation, they are less likely to complain about the lack of quality of the education that they receive. In addition, the lack of a repayment obligation means that there will be no defaults, which within the loan system have often been a key indicator of problematic institutions.

At the same time, however, the Subcommittee's 1993 hearing appeared to give at least some reason for optimism. The Subcommittee heard from the new administration of the Department of their candid acknowledgement of past failures and their commitment to, "make the program work better and frustrate the efforts of those who would abuse it."

Dr. David Longanecker, Assistant Secretary for Postsecondary Education, testified at that hearing as to the Department's efforts to strengthen its gatekeeping and monitoring functions and to enhance their efficiency. He also promised the Subcommittee "a lot better management," and expressed the hope that he would come back in a year or two to demonstrate that he has fulfilled that promise.

Here we are 2 years later, and we will indeed be providing Dr. Longanecker an opportunity to discuss the Department's management, and I have read his opening statement and I will say that there are significant plans that are being announced this morning by the Department to deal with some of these abuses.

Unfortunately, that discussion will be taking place in the context of yet another major failure on the part of the Department, a failure which led to almost $58 million of taxpayer money going to a school that was little more than a Pell Grant mill. Moreover, it appears that the abuses of this school continued for a number of years right under the noses of Department of Education reviewers, auditors, and investigators who were on the site conducting examinations of the school while the misconduct was going on.

Today, the Subcommittee will hear from the staff on its year-long investigation of IADE Schools. IADE was a Los Angeles-based proprietary school which offered short-term certificate-granting programs in computer operations, professional tractor trailer driving, and automobile repairs. In 1989, IADE was certified as eligible to participate in Federal student aid programs, including the Pell Grant program. In a little over 4 years, IADE's Pell Grant receipts increased by over 1,700 percent. By the 1993–1994 award year, IADE was the 16th largest recipient of Pell Grants of all schools in the Nation.

The staff will report that IADE's primary concern was the maximization of Pell Grant funds and, regrettably, not the training and placement of students. Among the findings the staff will report today are that many IADE students, including some who could neither read nor write, were enrolled in IADE courses, in apparent violation of Pell Grant ability-to-benefit requirements.

Instruction in IADE courses was woefully inadequate due to a lack of books and equipment, unqualified instructors, and deficiencies in course design and curriculum. In the vast majority of cases, placement of students was either ineffective or non-existent, and IADE officials deliberately covered up this fact by creating false records designed to mislead Federal, State, and accrediting officials.

IADE was engaged in abusive and possibly fraudulent practices, including the falsification of student records, in order to obtain Pell Grants for students who either had never attended or had withdrawn. IADE's owners used the school's Pell Grant receipts for such purposes as child support payments, leases on Mercedes Benz and BMW automobiles, trips to Club Med, and purchases at Victoria's Secret. IADE deceived and misled Federal, State, and accrediting officials engaged in conducting official reviews of the school's operations, policies, and procedures.

As disturbing as these findings are, unfortunately, they are not uncommon among many short-term non-degree-granting proprietary trade schools. Almost every Semi-Annual Report of the Department's Inspector General for the last few years has contained at least 4 or 5 cases involving abuses of the Pell Grant program among this sector of the educational community. Today, the Subcommittee will, no doubt, hear of other instances from the Inspector General.

In our 1991 report on "Abuses in Federal Student Aid Programs," the Subcommittee found widespread abuse of the guaranteed student loan program within the proprietary school sector and we recommended that Congress should consider the feasibility of setting reasonable limits on the type of proprietary school education that Federal dollars should subsidize. To date, such consideration has not been undertaken. I think that has been a mistake. I believe the time has come for the process to begin. In fact, it is overdue.

At a time when the Senate has passed a budget resolution which calls for severe cuts in Federal student aid programs, we cannot continue to suffer the waste of taxpayers' money on schools like IADE. Every dollar of Pell Grant money which goes to illegitimate and abusive schools results in a direct reduction of the funds available to needy students to obtain a truly worthwhile education. It is time we stopped treating these schools the way we would treat Emory University or the University of Delaware.

That is not to say that all proprietary schools, merely because of their nature as for-profit institutions, are illegitimate or abusive. Certainly, there are legitimate proprietary schools that are committed to providing their students with a quality education. By the same token, the Subcommittee's hearings in 1993 revealed that some non-profit institutions can also be abusive. Unfortunately, there are too many institutions, the majority of which are for-profit, that exist merely to take advantage of the Pell Grant and other Federal student aid programs and that care little for the utility of the training they provide. We cannot afford to subsidize such schools with Federal funds.

While this hearing is important for the focus it brings to the participation of questionable schools in Federal student aid programs, it is also important for the focus it brings to the Department's management of these programs. As I stated earlier, this Subcommittee had high hopes for the Department at our 1993 hearing. I stated my hope that the new Education team would give this issue high priority and that they would give the Department the strong leadership and management which it so clearly lacked and so clearly required.

That is why it is particularly disturbing to me to learn that the regulatory system for which the Department is responsible is apparently, based on this case, still incapable of either preventing fraudulent institutions from gaining access to student aid programs or of detecting and pursuing fraud by such institutions once access has been gained.

As we will hear from the staff, during the 5 years that IADE participated in Federal student aid programs, it was the subject of over a dozen audits, examinations, investigations, and reviews conducted by State licensing authorities, independent accrediting agencies, independent certified public accountants, and the Department of Education itself. At various times, IADE was found to owe the Federal Government money for student funds it should not have used. Yet, the school was never terminated from the aid program until it voluntarily closed its doors and filed for bankruptcy in March of this year, after our Subcommittee had been investigating for a number of months.

In conclusion, I would like to thank Chairman Roth and his staff for the support they have given us for our continued pursuit of these issues. These student aid programs are among the most important of all our Federal programs because of the opportunities they provide to millions of young people to better their lives and to be fully participating citizens in our political and economic system.

I look forward to working with the Chairman and all members of the Subcommittee to ensure that the focus of these programs remains on these young people, and to do everything we can to ensure that both they and the taxpayers are protected.

Mr. Edelman and Mr. Webster, as you know, we swear in all the witnesses before the Subcommittee, so I will ask you to take the oath.

[Witnesses sworn.]

Senator NUNN. Why don't you proceed with your staff statement?

TESTIMONY OF R. MARK WEBSTER, STAFF INVESTIGATOR TO THE MINORITY, AND ALAN EDELMAN, COUNSEL TO THE MINORITY, PERMANENT SUBCOMMITTEE ON INVESTIGATIONS, U.S. SENATE

Mr. WEBSTER. Mr. Chairman, we have a very lengthy statement this morning that we would like to summarize and include the full statement in the hearing record.

Senator NUNN. Without objection, it will be.[1]

Mr. WEBSTER. Mr. Chairman and members of the Subcommittee, for the past 5 years now the staff has been reporting to the Subcommittee on its investigation of problems with the management and oversight of the Federal financial student aid programs. This investigation began with an examination of the guaranteed student loan program. That examination led to a series of hearings, beginning in 1990, and culminated in the issuance of a 1991 Subcommittee report which set forth what the Subcommittee termed overwhelming evidence that the guaranteed student loan program, particularly as it relates to proprietary schools, is riddled with fraud, waste, and abuse, and is plagued by substantial mismanagement and incompetence.

The Subcommittee's report contained over 25 separate recommendations for reform of the loan program. Many of those recommendations were ultimately incorporated into amendments to the Higher Education Act which were passed by the Congress and signed into law by President Bush in 1992. The amendments were designed, among other things, to tighten institutional eligibility and to strengthen the triad of State licensure, independent accreditation, and Federal certification.

Subsequent to the passage of these amendments, the staff undertook an examination of the Federal Pell Grant program. With over $6 billion awarded annually, the Pell Grant program is the largest direct Federal student aid program. The staff's examination led to hearings in 1993 which revealed that the Pell Grant program was beset by many of the same systemic weaknesses that plagued the student loan program.

[1] See page 63

In particular, the hearings focused on the failure of the Department of Education's gatekeeping and program review procedures to prevent or detect fraud and abuse. These failures were of particular concern to the staff with respect to the Pell Grant program because apart from strong and continuous oversight, the Pell Grant program does not contain any structural indicators to alert one to the possibility of ongoing abuse by program participants. Indeed, as the Department's Inspector General put it during the hearings, the Pell Grant program by its very design is vulnerable to fraud and abuse because it operates essentially on the honor system.

The staff noted during the hearings that the Department's Inspector General cited a number of proprietary trade schools in the previous few years for abuses which involved tens of millions of dollars. One, in particular, IADE American Schools, attracted the attention of the staff and became the subject of our case study.

In 1992, IADE, facing the prospect of being disqualified from further participation in Title IV programs as a result of a rising default rate on its student loans, voluntarily ceased processing student loan applications for its students.

Senator NUNN. Mr. Webster, let me ask you this question. How did you choose IADE?

Mr. WEBSTER. Pretty much——

Senator NUNN. Did you draw it out of a hat? Was there some signal that went off? Did somebody get in touch with you? Describe how the choice was made to investigate this school?

Mr. WEBSTER. Pretty much out of a hat, using some basic guidelines. We wanted to find a school that had high default rates in the beginning and subsequently, for one reason or another, dropped out of participation in the loan program and participated solely in the Pell Grant program.

I reviewed a lot of records from the Department of Education looking for such a school and I ran across IADE American Schools and noticed that they had a dramatic increase in the amount of Pell Grants that they drew down since 1992 when they ceased participating in the loan program. At the time we chose it, we did not have any allegations that IADE had any problems. We just had indications that they had rapid growth and started looking at them based on that criteria.

In the 2 years prior to IADE ceasing participation in the loan program, they drew down slightly under $4 million in Pell Grants. In the 2 years following its cessation of loan activity, IADE drew down a total of approximately $30 million in Pell Grants.[1] Just to give you some idea of the size of the Pell revenue at IADE American Schools compared to some schools familiar to you, Mr. Chairman—Emory University, Georgia State University, and the University of Georgia—as you can see, IADE drew down much, much more in Pell Grant revenue than any one of those three much larger universities.[2]

The staff began its investigation of IADE in April of 1994. In the late summer of 1994, the Civil Fraud Division of the Department of Justice began an investigation of IADE. Subsequently, an IADE

[1] See Appendix A to staff statement, page 96.
[2] See Appendix B and C to staff statement, pages 97–98.

employee wrote an anonymous letter to IADE's accrediting agency in early 1995 alleging Pell Grant program abuses at IADE.

As a result of this letter, the accrediting agency undertook an unannounced site visit to IADE, which led to the agency's instituting action in March 1995 to withdraw their accreditation of IADE. Faced with the possible loss of its accreditation, an ongoing Justice Department investigation, and the Subcommittee's own investigation, IADE closed its doors on March 13, 1995.

IADE apparently expended much time and effort on maximizing the amount of Pell Grants it could obtain. It seemed to spend little time or effort on providing its students with a quality education. Indeed, the only time IADE seemed concerned with its students' education was when it had to demonstrate the nature of that education to State, Federal, or accrediting agency reviewers.

The staff interviewed numerous students and instructors concerning this issue. A common thread running through all of these interviews was the poor quality of education offered by IADE. While the staff found many dedicated instructors working at IADE, their efforts were consistently undermined by IADE's owners and senior management.

The staff was told that automotive technician classes at IADE often consisted of more than two dozen students crowding around the engine of one single car, making it nearly impossible for each student to see the part of the engine being worked on. One instructor told the staff that his students had tried to talk him into bringing his car so the students could work on it in class. He stated that he refused because he was not confident enough of his students' abilities to let them work on his own car. An IADE student with whom the staff talked was not so smart. He was convinced to bring his own car for his fellow students to work on in class. He told the staff that in the course of learning how to fix cars, they so ruined his car that it never ran again properly.

However, when the time came for IADE's reaccreditation site visit, the school suddenly obtained a new engine for its students. Unfortunately, none of the students was allowed to train on the engine. Indeed, they were told that they were not even allowed to touch it. When the accrediting team left the campus, so did the engine.

Senator NUNN. Does the accrediting team interview students when they go to the campus like that?

Mr. WEBSTER. Yes, they do. Apparently, they didn't interview the same students we did. We had information that when the accrediting team was there, IADE officials chose the students that the accrediting team would interview. In other words, they filled the classes that the accrediting team would visit with students who were coached in what to tell or what to answer with respect to their questions.

Senator NUNN. Did you have any trouble getting information from students when you visited the campus?

Mr. WEBSTER. No, sir, we didn't. In fact, after we arrived in California, we were there a few days; it was like the flood gates opened. We received phone calls from many, many students very eager to talk to us.

IADE's efforts to spruce up for reaccreditation visits were evidently quite blatant. A Department of Education IG investigator told the staff of accompanying officials of the State licensing agency on an unannounced site visit to IADE. The investigator stated that at the time they arrived, they found IADE in the midst of preparing for a reaccreditation site visit.

According to the investigator, as they walked around the school's campuses, they noticed that additional equipment was coming out of the woodwork. Strangely enough, though, the investigator apparently took no action to inform the accrediting agency of her observations, nor did she refer the matter for further follow-up by the IG itself. The reasoning the investigator gave the staff for this was that she had only been at IADE to act as an interpreter for the State officials and had not been there in an investigative capacity.

Senator NUNN. Is she still working for the Department of Education?

Mr. WEBSTER. To the best of my knowledge, she is.

Senator NUNN. And what is her job?

Mr. WEBSTER. She is an investigator, a criminal investigator.

In addition to failing to provide its students with a quality education, IADE also failed to provide them with adequate placement services. In contrast to its enticing advertising claims of over 70 percent placement and its promises to students of jobs with beginning wages ranging from $7 to $15 per hour, IADE did little to assist its students in finding employment in the fields for which they had been trained. To hide this fact from the accreditors and the regulators, IADE engaged in a pattern of deception and falsification designed to make it appear that minimum placement requirements were being met.

Students in IADE's truck driving and computer systems programs also complained about failed promises with regard to placement. A review of a random sample of the placement records of students in these programs shows the following results, which are on the tripod now.[1] As you can see, one graduate, Edin, of the computer operations course, is now a pit boss at a casino. Jose also graduated from computer operations; now, he packs bags. Jesus, another computer operations graduate, now works as a bartender.

IADE's poor placement services almost led to the school losing its accreditation in July 1992. During a reaccreditation site visit that year, the accrediting agency not only found IADE's placement services to be deficient, but stated that the results of its placement efforts are detrimental to its perceived integrity and stature in the community.

Partly as a result of IADE's problems with placement services, the accrediting agency deferred granting IADE reaccreditation until April 1993, pending receipt of additional information and a follow-up visit to all branch campuses. When those follow-up visits took place in March 1993, the accrediting agency reviewers found what they termed a dramatic turnaround. What the reviewers did not know, however, was this dramatic turnaround was the result of an elaborate pattern of deception directed by the highest levels of IADE's management.

[1] See Appendix D to staff statement, page 99.

A former IADE placement counselor informed the staff of what she called a virtual dirty tricks crew which was used by IADE to falsify and inflate placement statistics. According to her, 8 to 10 IADE employees were sent to the local courthouse to obtain names of companies which had filed for bankruptcy. These companies were then cited in IADE's records as locations where students had been placed, with the full knowledge that there was little chance that any verification could be done.

Arnoldo Sanchez, another former IADE employee, told the staff of other methods utilized by Bernardo and Sergio Stofenmacher to falsify placement data and deceive the accrediting team in connection with their follow-up visit. According to Mr. Sanchez, he was directed by Sergio Stofenmacher to disconnect one of IADE's fax machines and to answer that number as if it were a place of business.

Another IADE employee then gave the accrediting team reviewers the number, telling them that it was a number of a business which employed IADE students. When the reviewers called the number, Mr. Sanchez answered and confirmed that the particular student in question worked there. Mr. Sanchez told the staff that during the follow-up visit, everything was a show designed to cover up IADE's problems and to fool reviewers into believing that IADE had come into compliance with the accrediting agency's requirements.

Senator NUNN. Could you stop right there, Mr. Webster, and just—you have been in investigations a long time yourself now. You are an investigator, you are out there in the field, you have got somebody who owns a school who is obviously trying to deceive, and doing a pretty good job of it. What should the investigators have done in those circumstances? You are looking at it now from this perspective. What should they have done that they didn't do when they were out there basically being led down a fraudulent trail?

Mr. WEBSTER. As far as the accrediting team reviewers, I have no knowledge of their level of investigative expertise. Had I been on the team, though—actually, if they are intent on defrauding a reviewer, unless some flags go up somewhere along the way, it is pretty hard to catch it. The reviewers looked at it on face value, saw no indicators of fraud occurring, and didn't check into it any further.

Mr. EDELMAN. I might just add, though, Senator, that at the time that this deception happened, it was on a return visit by this accrediting team. They had been at the school only a few months previously and had found tremendous problems in the placement area, so much so that they gave the school the lowest possible rating that it could in that particular area. And when they came back in a matter of only a few months' time, suddenly there was this—as they themselves used the term, a dramatic turnaround. At least in my opinion, one should have questioned how a school like that could have achieved such a dramatic turnaround in so short a time period.

Senator NUNN. OK, you question it. You are skeptical. What do you do then?

Mr. EDELMAN. Well, try to talk to students, try to talk to students of your choosing rather than students of the school's choosing.

Senator NUNN. Letting them choose the people you talk to is a fundamental investigative error, right?

Mr. EDELMAN. I would think so, because you are always at risk that the students that are given to you have been coached in some manner.

Senator NUNN. How about talking to former students?

Mr. EDELMAN. Certainly, I think that probably also should have been a step that should have been taken.

Senator NUNN. Any evidence that that was done?

Mr. EDELMAN. Not that we are aware of, no.

Mr. WEBSTER. No.

Mr. EDELMAN. We are also not aware of the extent to which they actually tried to contact employers to verify placement statistics. Basically, they just seemed to take what they were given by the school at face value without taking into account this dramatic turnaround in such a short period of time and believing what they were told by the school.

Mr. WEBSTER. We also found it helpful when we talked to both current and former employees. They had a lot to tell us, too.

The staff's investigation has also revealed that IADE engaged in a widespread pattern of altering student financial aid files, including the forgery of student signatures on official forms and documents and the falsification of information on course attendance and grade sheets. These actions were consciously undertaken for the purpose of obtaining Pell Grants for students who had never enrolled at IADE and of avoiding making required refunds for students who had enrolled but had subsequently dropped out. As a result of these actions, IADE improperly obtained and retained millions of dollars in Federal student aid assistance funds.[1]

The staff discovered that numerous students who had merely inquired about IADE's programs without ever enrolling unwittingly became students in IADE's records for whom the institution received multiple Pell Grants. Such is the case of Maria Arana. On February 1, Ms. Arana went with a friend to the Santa Ana campus of IADE to inquire about taking computer courses. After Ms. Arana had talked to a couple of IADE employees, she decided not to enroll in IADE. She told the staff that she felt that Anna, one of the employees she talked to, had been too pushy and that she seemed more interested in getting her to sign forms than in explaining to her what IADE had to offer.

Despite Ms. Arana's decision not to enroll at IADE, it appears that IADE nevertheless enrolled Ms. Arana. The chart[2] here shows a no-show list with Ms. Arana's name on it, meaning that IADE American Schools expected Ms. Arana to show up for class because she had actually enrolled. The staff examined IADE's student records and found Ms. Arana's name on a list of no-show students, as we just saw there.

[1] See Appendix E to staff statement, page 100.
[2] See Appendix F to staff statement, page 101.

An examination of IADE's master sheets, however, uncovered additional information relating to Ms. Arana which was quite disturbing. Master sheets, of which we see one page of a master sheet here, show, among other things, the particular classes that the student has taken, whether the student has maintained satisfactory progress, and the date and the amount of any financial aid received.

The staff discovered that included among IADE's master sheets was this one for Ms. Arana.[1] The master sheet recorded Ms. Arana as having started a program in English as a second language. In light of Ms. Arana's statement to the staff that she never attended IADE, the only way in which IADE could have maintained the information which it had for Ms. Arana, and therefore the only way in which it could have obtained a Pell Grant for Ms. Arana, would have been through the creation of phony attendance and academic records.

Can we go back to the previous chart, please?

If you look in the lower part right in the middle of the master sheet—I realize this is difficult to see, but there is a square there that highlights two payments of a Pell Grant of $1,150. So what this is telling us is that IADE actually drew down $2,300 worth of Pell Grant funds in the name of Ms. Arana, a student who never attended IADE American School classes.

The staff found numerous master sheets showing academic progress and Pell Grant disbursements for other students. We have examples of 13 students, in addition to Ms. Arana, who were listed by IADE as no-shows. The staff found no record of IADE ever having made any refunds for any of these students, to include Ms. Arana, and again we see here the $1,150 actually paid for Ms. Arana.

Senator NUNN. Are those checks made out, the Pell Grant checks, to the student and the school, or are they made out directly to the school? Did she have to sign any of those checks?

Mr. WEBSTER. In IADE's case, the students normally sign the check directly over to the schools.

Senator NUNN. So she had to sign the checks before they cashed them?

Mr. EDELMAN. Well, the Pell Grant system works on a drawdown basis where the school—it is really sort of an electronic funds transfer where the school is able electronically to draw down funds from the Government's accounts.

Senator NUNN. Without the student ever having signed anything?

Mr. EDELMAN. The money is then supposed to be applied to the student's account to cover whatever tuition or other expenses the student has with the school. If there is then any money left over, that money is to be given to the student.

Senator NUNN. But the student never has to touch the check?

Mr. WEBSTER. The student doesn't actually touch the check, but the student does have to sign something. There is something called an Electronic Student Aid Report that the student has to sign in

[1] See Appendix G to staff statement, page 102.

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order for IADE or the institution to actually cash the check or draw down the money in the name of that student.

Senator NUNN. Well, did you ask this particular individual whether she had signed anything.

Mr. WEBSTER. She never received anything, never signed anything that resembled an Electronic Student Aid Report.

Senator NUNN. Do you have a copy of the report that was filed for her?

Mr. WEBSTER. We have no record of that report.

Senator NUNN. So before the Department of Education could put money in the Pell Grant account for this particular individual, she had to sign something, and that form had to be sent to whom?

Mr. WEBSTER. It is maintained in a student record at the institution.

Senator NUNN. It doesn't go to the Department of Education? They don't see a copy of it?

Mr. WEBSTER. No, they don't.

Senator NUNN. So they are really taking the word of the school, is that right?

Mr. WEBSTER. They are taking the word of the school that the form is actually signed by the student.

Senator NUNN. So the student doesn't enter into the picture at all in this equation?

Mr. WEBSTER. In this case, no, it didn't.

Mr. EDELMAN. The forms are handled by a processor on the part of the Government who reviews the forms, and then the forms are sent back and the student is supposed to verify the information that is on the form and then sign it and return it to the school, and then the school is to maintain the signed copy.

Senator NUNN. Do student loans work the same way? The student actually has to sign, I am sure, to get a loan, right?

Mr. EDELMAN. Given the recent changes, that may be a question best put to the witnesses to come from the Department of Education. We haven't looked that closely at the processes of the loan program in the last couple of years to give you a proper answer to that, I think.

Senator NUNN. Well, by law, you can't make a loan unless you sign a paper.

Mr. EDELMAN. Oh, certainly. You would have to have the student verify the financial information and all on that and there would be a promissory note as well.

Senator NUNN. Well, I will ask our Education witnesses later about exactly how that transfer of money on Pell Grants works, whether the student herself has to participate in that, whether the student actually ever sees the money or actually has to sign something that goes to the Department, in lieu of just staying with the school.

Mr. EDELMAN. One of the key things to keep in mind here, also, is that the way the Pell Grant program works is that the schools are allowed to draw down this Pell money in advance—I believe, it is 21 days in advance of the student actually starting classes. If a student is a no-show or never attends, then the school is obviously under a requirement to reimburse that money, refund it to the Department.

That is where you get into the whole issue, which happened with IADE in a number of instances, where the school, because of deficiencies, was put on what is known as the payment by reimbursement system. This means that rather than being allowed the privilege of drawing down money in advance of a student's enrollment, the school is required to prove to the Department for each student that the student actually did enroll and began classes before the school can collect the money for that student.

Senator NUNN. OK.

Mr. WEBSTER. Senator, giving IADE the benefit of the doubt, thinking, well, maybe human error—all this happened, all these forms were filled out. Indications were that they received $2,300 in a Pell Grant for Ms. Arana. We wanted to check with the Department of Education to make sure that $2,300 had been drawn down in the name of this student, so we requested a student payment summary, looking for Ms. Arana's name, and unfortunately her name was there. So, in fact, $2,300 worth of Pell Grant funds was drawn down in her name by IADE American Schools.

IADE's fabrication of records to create enrolled students was blatant and intentional. Moreover, this fabrication went beyond the creation of ghost students and included the falsification of records pertaining to students who had, in fact, enrolled, but subsequently withdrew or dropped out of school. If IADE received a Pell Grant check on behalf of a student who had withdrawn before completing at least half of his course, the information on the student's master sheet would be changed by IADE employees to make it appear that the student had completed half of the course in order to avoid paying a refund.

The former financial aid director at IADE's South Gate campus told the staff that she was directed not to post no-shows or drops at all because to do so would generate too great a refund liability for which IADE did not have the money. Apparently, this deliberate failure to post drops and no-shows went on for quite some time.

On July 14, 1994, Mr. Ken Williams, the former financial aid director of IADE American Schools, addressed a memorandum on this issue to the Stofenmachers and IADE's corporate counsel, Gonzolo Frixes. Interestingly, this memorandum was marked "urgent and confidential," and stated that it was not to be shared with anyone other than those to whom it was addressed.[1]

In his memorandum, Mr. Williams stated, "There are approximately 1,607 students who are no-shows, withdrawals, terminations, etc., who have not been posted to the RGM system as no longer enrolled. As such, these students when posted will create approximately $1,035,310 in additional refunds." Mr. Williams went on to estimate that as of June 30, 1994, IADE's total liability in refunds due, including both posted and non-posted refunds, was nearly $2.5 million.

Mr. Williams' memorandum is amazing in its candor and provides perhaps the clearest picture of the types of abuses which were occurring at IADE. For example, at the beginning of his memorandum, Mr. Williams stated, "As you are aware, during this

[1] See Appendix H to staff statement, page 104

same period between 7/1/93 and 6/30/94 in order to increase cash flow we eliminated a number of checks and balances which allowed checks to print which would not normally have printed and/or deposited into IADE's general fund."

"Relaxing previously existing procedures allowed IADE to significantly increase cash flow in the short run. However, in the long run, the changes dramatically increase the amount of refunds due. For example, many of the students for whom we printed and deposited checks, should never have received any Pell Grants at all. Consequently, as soon as the drop information is posted for these students, we will be forced to pay back all of the money we received for them. As I warned when IADE senior management first decided to do this, the long term implications for refunds owed has been dramatic."

"It should be noted that it may be possible to move," Mr. Williams continues, "some of these payments and postings back and forth by as much as two to 4 weeks. However, the greater the delay the greater the risk we run in terms of audits, excess cash, reimbursement and/or having our aid eligibility and/or license to operate terminated."

Perhaps most incredible is the concluding admonition contained in Mr. Williams' memorandum in which he warned of the consequences of not correcting the refund problem. There, he stated, "IADE will be required to undergo what are now annually required student aid audits and will, as we have already been admonished by the Nunn Committee, be required to provide audited financial statements. These audits coupled with the audited financial statements will, given the auditor's familiarity with the RGM system, reveal the unpaid refunds. Even if we retained an auditor unfamiliar with RGM, the refunds would either be discovered during the file review or would be discovered when the auditor, as required by Federal law, met with RGM."

And he continues, "Frankly, even once the refunds are paid, they are already late. As such, the longer we wait to pay the refunds the greater the risk to IADE. Our biggest dilemma is that though we could once again relax check printing procedures to generate more income in order to pay the 93–94 refunds, this would only create more refunds next year and make the problem worse assuming we could hide it for another year which, frankly, we can't. Frankly, in light of the Nunn investigation, if they discovered and could prove that IADE had deliberately hidden refunds and provided false information to Congress, IADE's senior management could face criminal prosecution. I say this not to scare you, but to point out as I have before that we have to fix this problem before it is discovered by some outside agency."

Mr. Williams also appeared at a video deposition conducted by the Subcommittee staff and was advised of his right to have the benefit of counsel. When we deposed Mr. Williams concerning this memo, he admitted that only a small percentage of the refunds owed by IADE had actually been paid and Pell Grant checks had been deposited without verifying if the corresponding Electronic Student Aid Reports had actually been signed.

If we may, we have a short videotape of a portion of this deposition where Mr. Williams describes the level of intent to defraud. I

have to mention at this juncture that on the tape Mr. Williams begrudgingly admits to knowing that the owners were defrauding the Government and involved in criminal activities. He admits to choosing to remain ignorant of these activities and not reporting them to any authority.

Mr. Williams was evasive and at times tended to ramble on in his answers. As such, when editing this portion of the tape for this hearing, it was sometimes necessary to cut off some questions or answers. The full videotape is nearly 2 hours in length, and I would ask to include it in the record.

Senator NUNN. Without objection.[1]

Senator NUNN. Now, what was his position at the time this was made?

Mr. WEBSTER. He was the financial aid director.

Senator NUNN. Was the school still in existence when this videotape deposition was made?

Mr. WEBSTER. No, it was not.

Senator NUNN. It had already gone bankrupt?

Mr. WEBSTER. It had already filed for bankruptcy.

Senator NUNN. Was he still employed then or was he a former financial officer?

Mr. WEBSTER. He is now the former financial aid officer.

Senator NUNN. What was he when you made the tape, former at that stage?

Mr. WEBSTER. Former when he made the tape, but he currently, and when we made the tape, is employed by IADE's processor, RGM.

Senator NUNN. Was he represented by counsel during this tape?

Mr. WEBSTER. He chose not to be represented.

Senator NUNN. He was fully advised he could be represented?

Mr. WEBSTER. Yes, he was.

Senator NUNN. Approximately how long is the tape that you are going to show us?

Mr. WEBSTER. A little less than 5 minutes.

Senator NUNN. It is edited, right?

Mr. WEBSTER. Excuse me?

Senator NUNN. The tape is edited?

Mr. WEBSTER. Yes, it is.

[Videotape shown.]

Mr. WEBSTER. I also need to mention that Mr. Williams, prior to being employed with IADE American Schools, was formerly with the California State Guarantee Association.

As has been mentioned previously in this statement, IADE American Schools took into approximately $58 million in Federal Pell Grant money from 1990 to 1995. Based on what the staff discovered during its investigation, it appears that very little of that money was used by IADE to provide books, supplies, equipment, placement services, or any of the other necessities of a quality vocational education.

Much of the Federal money which IADE did receive was for students who either withdrew or never attended, and for whom IADE therefore incurred little or no expenses. In light of this, one would

[1] See Exhibit #5, page 157.

think that IADE should have had no cash flow concerns. A closer examination, however, shows that IADE has been in serious financial difficulty for a number of years.

The staff also obtained a sense of IADE's financial difficulties from interviews with various IADE employees. Many told the staff that from time to time, their paychecks were not honored by the bank for lack of funds. Luz Zamorena, IADE's former office manager and director of personnel, told the staff that IADE's financial problems seemed to start about the time Sergio Stofenmacher came to the school in 1990. Beginning in 1990, accounts which previously had always been paid on time increasingly became past due. Ms. Zamorena also confirmed to the staff that on at least three occasions, once in 1992 and twice in 1993, her paycheck and those of at least 50 other employees were not honored.

Where did the money go? Well, according to Mr. Sanchez, IADE's problems with insufficient funds often seemed to coincide with those times when Abraham Stofenmacher returned to Argentina. In addition to the statements of IADE's employees, the staff's review of IADE's general ledgers and check registers also provided some interesting information as to where some of IADE's money was going.

The staff undertook a limited review of checks written by IADE during the 6-month period of August 31, 1993, through January 31, 1994. During this time, IADE's revenue from Pell Grant drawdowns was over $8 million. The staff's review uncovered these payments before you for the 6-month period.[1]

The staff notes that Alley Parking, Basa Management, COTC, and T&P Advertising, which received a total of almost $600,000 during this time period, are all companies owned by the Stofenmachers. The payments to Mercedes Benz and BMW Credit Corporation represent payments on leases of vehicles which were used personally by the Stofenmachers. As you can see on this chart here, it is a lease agreement for a BMW.[2] While we have no problem with a corporation providing corporate vehicles for employees, as you can see in the highlighted portion of this lease agreement, which apparently is signed by Bernardo Stofenmacher, he initialed the block where it says the vehicle is going to be used for personal, family, or household purposes.

Also of note during IADE's payments is the—if we can go back to the previous chart, please—is the payment of $2,541.50 paid from the school's account for child support payments. From what the staff has been able to determine, these payments were made to satisfy child support personally owed by Sergio Stofenmacher.

A number of checks were also written out in the names of the individual Stofenmachers. Each of the Stofenmachers received a substantial annual salary. Abraham received $146,000, Bernardo and Alejandro received $200,000, and Sergio received $220,000. In addition to their salaries, at least some of the Stofenmachers also received interest-free loans from IADE. IADE's financial statement for the period ending January 31, 1992, lists $144,395 in advances to officers.

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[1] See Appendix I of staff statement, page 107.
[2] See Appendix J to staff statement, page 108.

By the time of the following year's financial statement—that is, for the period ending January 31, 1993—that figure for officer advances had ballooned to $379,833. A review of IADE's general ledger, however, reflects no repayments by any company officer, nor was there any evidence found of such repayment. The mysterious rise and fall and rise again of the figure for officer advances is perhaps symptomatic of larger problems with respect to IADE's financial accounting.

The members of the accrediting team found that IADE was extremely behind in its accounting. One of the team members subsequently told the staff that IADE's accounting practices were so poor that he didn't think that the school would even have known if it had bad debts. Indeed, the team member was of the opinion that IADE did not have a clue as to what their financial status was and that, as a result, it was just making up its financial statements.

If this is true, it certainly has serious implications not only for IADE's ability to provide an accurate picture of its financial condition, but also for its ability to account for the millions upon millions of Federal taxpayer dollars which the school received over the years. This chart [1] showing their total revenue versus the Title IV funds that they received reflects what the team member's opinion was that they did not have a clue as to what their financial status was.

If I may point out the year 1992 and 1994, when Title IV revenue exceeded what IADE American Schools listed as their total revenue in their financial statements.

Senator NUNN. How could that be? How could you get more from one source than the total?

Mr. WEBSTER. The only explanation I have, Senator, going on what the team member said, is they just did not have a clue and they were simply making up their financial picture.

Senator NUNN. Did Mr. Sanchez tell you how the money was taken out of the school, how Abraham took the money away? Did he put it in a cashier's check? What did he do?

Mr. WEBSTER. Mr. Sanchez told us that he thought, or it was general opinion of other employees and Mr. Sanchez, that Mr. Stofenmacher took the money out of the country in a suitcase to Argentina, and he thought about $10,000 at a time.

Senator NUNN. Was that in cash?

Mr. WEBSTER. In cash.

Senator NUNN. After cashing the Pell Grant checks? How did the money get converted to cash?

Mr. WEBSTER. Either through one of their other companies that they owned, or taking it directly from IADE's accounts. From reviewing the check register we have a list of 800 checks written directly to IADE, much as one would write a personal check for cash. For, I think, about a 6-month time period, we found those 800 checks totaled $4.5 million, for which there is no explanation where the money went or what it was used for.

Senator NUNN. He said he was taking it out $10,000 at a time in a suitcase?

Mr. WEBSTER. That is what Mr. Sanchez said.

[1] See Appendix K to staff statement, page 109

Senator NUNN. That would take a lot of trips to get $4 million out.

Mr. WEBSTER. From what we understand, he does take a lot of trips to Argentina. He still has family down there.

Senator NUNN. Do you have any travel record?

Mr. WEBSTER. The only indication that we have that actual trips were made was right after the school closed, we found that one of the sons—in fact, the day IADE filed for bankruptcy, March 13 of this year, one of the sons purchased a one-way ticket to Argentina and has not been seen in Los Angeles since.

Senator NUNN. How many of the family remain in this country now?

Mr. WEBSTER. Just one.

Senator NUNN. Who is left?

Mr. WEBSTER. Bernardo Stofenmacher is the only one left.

Mr. EDELMAN. At this point, Mr. Chairman, we would like to turn to an examination of the role played by the various oversight agencies which had responsibility for this school and for management of the Pell Grant program.

Participation of institutions in Federal student financial assistance programs is subject to a regulatory triad consisting of State licensing authorities, independent accrediting agencies, and the Federal Department of Education. Each of these entities is responsible not only for making determinations affecting entry into the programs, a process which is known as gatekeeping, but also for conducting continuing oversight to ensure that a participating institution remains in compliance with applicable program requirements.

Over the years, this Subcommittee has been quite critical of the ability of this regulatory triad to prevent fraudulent institutions from gaining access to the program in the first instance or to subsequently detect and pursue fraud by such institutions once access has been gained. Unfortunately, the case of IADE represents one more example of a failure of this system.

From the time it first entered the Federal student financial assistance programs in 1989 until the time it closed its doors and filed for bankruptcy in 1995, IADE underwent close to a dozen audits, examinations, and reviews by the California Council for Private Postsecondary and Vocational Education, its State licensing authority; the Accrediting Council for Continuing Education and Training, its independent accrediting agency; and the Department of Education itself.

Each of these audits, examinations, or reviews found problems of varying degrees in one aspect or another of IADE's operations. At various times, IADE was found to owe the Federal Government money for student financial assistance funds it should not have used. Twice, IADE was placed on reimbursement for brief periods of time, and once there was even some consideration given to terminating IADE from the program altogether. None of the members of the triad, though, ever seemed capable of understanding the full extent of the abuse going on at IADE.

As a result, IADE managed to retain its access to Federal funding with little or no serious impairment of its activities until earlier this year, when an unannounced site visit by its accrediting agen-

cy, based on an anonymous tip, led to the termination of IADE's accreditation. By that time, however, IADE has taken in almost $58 million in Federal student financial assistance funds.

While participating in Federal student financial assistance programs, IADE was subject to continual institutional monitoring by its State licensing authority, its independent accrediting agency, and the Department of Education. Any one of these arms of the triad could have taken action against IADE which would have led to the school's no longer being eligible to obtain Federal dollars. Unfortunately, none of them seemed capable of taking swift, sure, and effective action to stop the ongoing abuses at IADE.

In order to participate in Title IV programs, an institution must be licensed or otherwise legally authorized to provide a course of postsecondary education by the appropriate agency in the State in which it is located. IADE was licensed by the California Council for Private Postsecondary and Vocational Education. IADE's licensing authority conducted its first substantive audit of the school's operations in May 1993. This audit was initiated to determine IADE's compliance with applicable laws and regulations pertinent to the administration of the school's English as a Second Language program.

The licensing authority found a number of areas of non-compliance in the course of its audit and directed IADE to undertake certain actions to bring the school into compliance. Despite IADE's refusal to comply with the licensing authority's directives, and despite the fact that failure to comply with auditing findings could form the basis for denial of a license, the licensing authority nevertheless granted conditional approval to IADE's ESL program until June 1994.

The primary condition attached to IADE's approval was that the licensing authority would then conduct a follow-up audit prior to the expiration of the approval. This audit was conducted in May 1994 and an audit report was subsequently issued in August of 1994. The 1994 audit contained a number of significant findings, including the following: a failure to provide financial documents to the audit team, or to provide them in a timely fashion; a failure to satisfy financial responsibility requirements; a failure to pay refunds in a timely manner; a failure to provide requested information pertaining to refunds; the disbursement of Pell Grants prior to the processing date of students' Electronic Student Aid Reports; and the disbursement of Pell Grant funds without confirmation of citizenship status. These are all indicators of serious institutional problems.

In October of 1994 IADE requested and was granted a 60-day extension to respond to the findings of this audit. The licensing authority found IADE's response to be inadequate and informed the school that it intended to pursue administrative action against the school. By this time, however, it was already January of 1995, over 1½ years since the licensing authority's first audit of IADE had discovered some of these problems. During that 1½ year period, IADE drew down over $10 million in Pell Grant funds.[1]

[1] See Appendix L to staff statement, page 110

If we could just go back to the previous chart for a moment, this chart shows—the blue line represents a running total of the amount of Federal funds that IADE was drawing down for the period 1990 through 1995, and each of the notations along the line of that chart show the various actions that were taken by the State licensing authority during that time period. So you can see that while the licensing authority was in there conducting its audits, making its findings, granting extensions to the school to respond to those findings, et cetera, the school was just racking up more and more money and the meter was continually ticking.

Even the licensing authority's decision to pursue administrative action, though, did not bring swift results. Apparently, although it has independent authority to license schools, it does not have independent authority to revoke licenses already granted. In order to do so, the licensing authority is required to refer the matter to the California attorney general's office. The attorney general's office then makes a determination whether to pursue an administrative action seeking revocation.

On January 9, 1995, the State licensing authority sent a memorandum to the attorney general's office referring the IADE audit issues for such administrative action. By the time IADE closed its doors in March of 1995, 2 months later, the attorney general's office had not yet taken any action on that referral.

In addition to being licensed by the State in which it is located, an institution must also be accredited by an independent accrediting agency approved by the Secretary of Education. IADE was accredited by the Accrediting Council for Continuing Education and Training, a body known as ACCET. That accreditation was granted on July 1, 1989.

Once again, as I go through this chronology, the chart[1] that is up here—the green line now is that same running total of Federal funds that was going to IADE and the various notations show the actions that were being taken by the accrediting agency at these various times.

In July 1992, ACCET conducted a review of IADE's operation in connection with its consideration of IADE's reaccreditation. That review found a number of areas of weaknesses, including the following: 1) IADE's business plan was considered elementary and not well thought out; 2) Numerous grade and attendance records had been whited out or changed; 3) There was an indication of inconsistent charges being levied for tuition and fees; and 4) Student records were found to be inadequate and placement services were found to be inadequate.

As a result, ACCET decided to defer a decision on IADE's reaccreditation pending the receipt of additional information from the school and follow-up visits to all campuses. In the meantime, ACCET received correspondence from the State licensing authority in August of 1992 informing it of a State investigation of certain complaints filed against IADE. On the basis of these complaints, ACCET scheduled an unannounced site visit to IADE. This visit took place in October 1992.

[1] See Appendix M to staff statement, page 111.

Among the findings from this visit were the following, which is a quote from the site visit report. "The tuition appears to be set at a level that given the length of the programs; [sic] it can be covered exclusively with Pell grants. Students interviewed commented several times that they are going to school free. Several students expressed frustration and confusion over how they are paying for school. They stated that they were told to "sign here, put this amount here, etc." and then the first week of classes they were told what they would be awarded. They do not understand that they are using two or three Pell grants, both partial and full, to pay for their education."

In light of the findings of this visit and several unresolved findings from the previous visit, ACCET determined to continue the deferral of IADE's accreditation. At the same time, however, ACCET directed IADE to show cause as to why its accreditation should not be withdrawn. Had IADE's accreditation been withdrawn, it would no longer have met the requirements to be an eligible institution for purposes of participation in Title IV programs.

Once again, however, IADE managed to dodge a potentially fatal bullet. IADE's response to the show cause directive apparently was convincing enough to lead ACCET to believe that the school was instituting the changes necessary to bring it into compliance with ACCET standards. In addition, an ACCET follow-up visit in March 1993 found much improvement in a number of previous problem areas. Describing these improvements, the follow-up report used such terms as "dramatic turnaround," "significant effort," and "noticeable changes."

On the basis of IADE's response and the follow-up report, ACCET determined in April 1993 to vacate the show cause directive and to grant IADE reaccreditation. Of course, what ACCET did not know in vacating its show cause directive was that much of what its site visit team had observed at IADE was a sham designed specifically for the purpose of deceiving ACCET into believing that IADE was in compliance with the accrediting agency's standards. We have previously cited many of the ways in which IADE carried out this sham.

In January of this year, ACCET received an anonymous letter alleging, "discrepancies in the operating procedures" of IADE. The letter hinted at issues of no-show students, inadequate documentation of prior skills, financial instability, and failure to pay refunds on time. ACCET officials viewed this letter as an urgent complaint and scheduled an unannounced site visit to IADE. This visit took place in February of this year.

The visit uncovered a number of serious problems, including the following which were detailed in the evaluation team's report: 1) Management did not demonstrate that its internal and external governance was effective; 2) Management did not demonstrate that the role of management was clearly defined, effective, or efficient; 3) The institution did not demonstrate a record of responsible financial management with income sufficient to maintain its educational programs; 4) The institution did not demonstrate that financial aid programs are capably administered, accurately recorded and documented, and appropriately implemented; and 5) The institution did not demonstrate that tuition refunded and received was

clearly documented and that cancellation and refund policies complied with Federal and State regulations.

On the basis of these findings, the accrediting agency issued IADE another show cause directive on March 2 of this year to show cause as to why its accreditation should not be withdrawn. By this point, IADE had just about run out of time. Within a week of the accrediting agency's show cause directive, IADE had shut its doors. A few days later, it had filed for bankruptcy.

In response to these actions, ACCET, in a letter dated March 16, 1995, withdrew IADE's accreditation. The withdrawal of the accreditation, however, came 2 years and 2 months after ACCET had issued its first show cause directive to IADE, and in that intervening time period IADE had managed to obtain over $34 million in Pell Grant funds.

Perhaps most disturbing of the various missed opportunities in this case is the fact that the Department of Education, despite having three separate teams examining IADE in 1992, either failed to comprehend or ignored indicators of the ongoing abuses at the school. Had the Department taken aggressive action in response to these indicators, it might have saved tens of millions of dollars in taxpayer money.[1] Instead, a review of the Department's actions reveals a tentativeness which ultimately led to the Department's letting IADE continue its activities with virtual impunity.

The Department's first review of IADE commenced in March of 1992. This review consisted of an audit conducted by a team from the Inspector General's Office of Audit and lasted from March 2, 1992, until November 9, 1992. The objectives of this audit were to determine, 1) "whether [IADE] American Schools' programs were eligible for SFA funds; 2), whether it had operated the SFA programs in accordance with Federal laws and regulations." According to the Assistant Inspector General for Audit, IADE had been selected for this audit because of its recent large increases in Pell Grant draw-downs.

Early on in the audit, the audit team began to receive allegations of potential fraud and abuse related to IADE's participation in Title IV programs. Joe Tong, one of the primary auditors conducting this audit for the Inspector General, interviewed Jorge Meza, the former director of IADE's Los Angeles campus. Mr. Meza stated in his interview that he had participated in falsifying student grades at the direction of Sergio Stofenmacher so that IADE could show the satisfactory progress of its students necessary to ensure the continued flow of Title IV funds.

In addition, Mr. Meza stated that IADE had altered ability-to-benefit test responses to make students eligible for financial assistance and had falsified its student placement statistics to meet Federal requirements. Finally, Mr. Meza informed Mr. Tong that IADE had been, "fixing" student records since being notified of the impending Inspector General audit back in February. In addition to his interviews, Mr. Tong's review of IADE files and documentation uncovered what appeared to him to be indicators of possible fraud and abuse.

[1] See Appendix N to staff statement, page 112

Mr. Tong documented all of these problems in his audit work papers and sent a report of his findings to his supervisor, Mr. James Okura. Mr. Okura apparently decided that these were not issues of concern for the purposes of the audit, despite the fact that one of the stated objectives of the audit was to determine whether IADE was operating student financial assistance programs in accordance with Federal laws and regulations.

Despite his supervisor's failure to see the significance of his discoveries, Mr. Tong contacted the Office of the Regional Inspector General for Investigations. Meanwhile, the audit was focusing in on just two issues—IADE's grading of ability-to-benefit tests to qualify students and IADE's maintenance of Pell Grant cash balances in excess of Federal regulations.

The Inspector General investigation which was launched in response to Mr. Tong's findings consisted of nine interviews with former employees and students of IADE conducted from March through August 1992. During those interviews, the investigators were told of low grades that were whited out and replaced with passing grades, of answers that were given to students taking ability-to-benefit tests, of documents that were created indicating students passing tests for courses they had never even taken, of tests that were falsified, of course assignments that were manipulated in order to maximize Pell Grant awards, of textbooks in English that were given to students for courses taught in Spanish, of placement statistics that were falsified. One former instructor even told the investigators that he had heard that IADE's owners intended to make as much money as they could in 1 or 2 years and then sell the school.

According to an internal Department document, on September 23, 1992, the Office of Inspector General indicated to the Department's Region IX office that it intended to ask the Department's Compliance and Enforcement Division to initiate termination action against IADE. This would have removed IADE from any access to Federal student aid funds.

In response to the stated intention of the Inspector General, the Region IX office asked the Compliance and Enforcement Division to place IADE on reimbursement. As you will recall, this is a system by which the school must document in advance that students have actually enrolled before the school could draw down Pell Grant funds for those students.

Senator NUNN. Instead of drawing the money first, they have to give the proof first and draw it later?

Mr. EDELMAN. Right.

The regional office subsequently decided to conduct a program review to support the decision to place IADE on reimbursement. That program review, however, lasted a total of 5 days. During those 5 days, the reviewers examined just 22 files for the award years 1990 to 1991 and 1991 to 1992. The reviewers did not focus on the allegations which had been received by the Inspector General investigators. Rather, they appeared to concentrate on the same issues the Inspector General's auditors had concentrated on; namely, the improper determinations under ability-to-benefit testing and the maintenance of excess cash balances.

The review concluded with what were considered to be minor findings. Even though the reviewers did not consider their findings particularly serious, IADE was still kept on reimbursement because of the Inspector General's supposed intention to pursue termination or other serious action against the school. On December 8, 1992, however, the Inspector General decided not to press for termination, and as a result the Compliance and Enforcement Division of the Department removed IADE from the reimbursement system, thereby allowing the school to draw down money in advance once again.

Despite the fact that the last substantive interview conducted by Inspector General investigators was completed in August of 1992, the Inspector General did not issue a report on its investigation until July 1993, almost a full year later. The entire investigative report consists of one-and-a-half pages. The report, written by Special Agent Robert Gonzalez, states, "An investigation was initiated in April 1992 based upon an interview of Jorge Meja [sic], former IADE school director. Meja [sic] stated that IADE, 1) violated its academic progress policy by not reflecting failing grades; 2) helps students pass ATB tests; and 3) is not accurately reporting its job placement rates.

"IS interviewed Jorge Meja [sic], two other former IADE instructors, Ignacio Rosas, Sergio Castro, and former employee Edgardo Rivas. In addition, various students were also interviewed. The interviews revealed a pattern of abusive tactics in recruiting and ATB testing designed to obtain maximum enrollments."

"Also, the interviewees confirmed that IADE management pushed staff to enroll as many students as possible and to report student progress electronically so IADE could earn student financial assistance payments as quickly as possible.

"However, no person interviewed, including the original complainant, made a credible allegation of criminal wrongdoing. Further, a credibility gap in the objectivity of the former school employees was evident to the interviewers due to the circumstances of their separation from IADE."

The staff finds it strange that Mr. Gonzalez left out of his report the allegations made by Mr. Castro and each of the other instructors interviewed concerning the falsification of grades, tests, and student records. Perhaps most disturbing, though, is Mr. Gonzalez' statement that, "no person interviewed, including the original complainant, made a credible allegation of criminal wrongdoing."

It is not clear to the staff why allegations of falsification of student records designed to allow a school to collect Federal financial assistance for an otherwise ineligible student does not rise to the level of criminal wrongdoing. Nor is it clear to the staff why the Inspector General investigators did not pursue the leads offered to them in their initial interviews to determine whether these allegations were, in fact, credible.

Mr. Meza, Mr. Castro, and Mr. Rivas all provided the investigators with names of other IADE employees who either knew of or were involved in potentially fraudulent activities. There is no record that the investigators ever interviewed these people, nor did the investigators ever interview Ken Williams, IADE corporate director of financial aid, or any of the Stofenmachers.

Senator NUNN. Mr. Edelman, you have been in law and investigation for a long time. How do you explain this? Does this mean that the people at the Department, the IG office—these are IG——

Mr. EDELMAN. These are IG criminal investigators.

Senator NUNN. Does this mean they are inadequately trained? Does it mean they are overworked? Does it mean there are too many schools to regulate and they have to move from one to the other? I mean, what do you deduce from this?

Mr. EDELMAN. We have been told by the Inspector General in discussing this with him that their office did, in fact, have a very heavy caseload and that their agents all handle numerous cases at the same time, and I think they may admit that perhaps they did not take some of the steps that should have been taken in this case. However, regardless of the number of cases that one handles, I think that to state that the kinds of allegations that they received in interviews did not rise to the level of criminal conduct is outrageous. I think clearly there should have been follow-up to that.

Senator NUNN. That is just unexplainable based on the allegations they had?

Mr. EDELMAN. We certainly have no explanation for it. One would think that IG investigators have a little more training in criminal investigation and procedures than perhaps the program review people, and so why they did not follow up on some of these things and why they did not think that the allegations they received were either credible or important enough is beyond the staff's capability to understand.

Senator NUNN. They were getting these allegations from employees and former employees?

Mr. EDELMAN. From both current and former employees of the school.

Senator NUNN. In your investigations, and you have done many of them, was this a tough one to crack?

Mr. EDELMAN. Not really. As Mr. Webster stated earlier this morning, we selected this school not on the basis of any inside information we had, but merely because of the drop in the loan portfolio and the rise of the Pell Grant portfolio, which is exactly the reason the Inspector General selected this school to audit.

We went out to Los Angeles to conduct our own field investigation in April or May of last year. Just prior—a day or so prior to going out on that trip—we received some of the information that the IG investigators had received in the course of their interviews. We took that and took the follow-up steps to pursue those allegations, and the flood gates opened and we found everything.

Senator NUNN. Can you conclude from this that the Department is understaffed or the IG is understaffed? Do you have any personal conclusions?

Mr. EDELMAN. Historically, I think, as the record created by this Subcommittee has shown, there has been a problem of understaffing at the Department, although I think in the last couple of years there have been increased resources granted to it.

Senator NUNN. Are the investigators adequately trained?

Mr. EDELMAN. We have found over the years a problem with the training of the program reviewers in terms of their not being given any training to give them the ability to detect criminal wrongdoing.

These, however, were Inspector General criminal investigators, which one would presume had a much higher level of training. I am not personally familiar with the type of training that the IG investigators undergo, so I can't speak to that. We have been informed that since the time of this case that the IG has undertaken some changes in the way it handles its investigations, so that hopefully another case like this will not reoccur.

Senator NUNN. Is this an area that is too complex, too many rules, too many laws, too many regulations?

Mr. EDELMAN. It is certainly a very complex area, and I think in previous hearings we have commented on the complexity of the regulatory scheme of the student financial assistance programs. However, I think a big part of what is necessary and perhaps what is lacking here is just that vigilance over the participating institutions and perhaps a need for a healthy skepticism of what Department employees are told by the institutions that they monitor. As has been said in previous hearings by Department Inspector General witnesses, this is a program that is run on the honor system, and unfortunately what we have are a lot of participants that are not honorable, and I think those who oversee this program have to realize that and have to approach it with that kind of an attitude.

Senator NUNN. Is the direct loan program that is being embarked on now in the Department of Education also going to be run on the honor system?

Mr. EDELMAN. From the indications that we have—and, again, I believe the Department witnesses may be able to address this a little better, but the information we have is that the system for the direct lending program will mirror in many ways the Pell Grant system in terms of schools being able to draw down the funds and then being responsible subsequently for making any refunds for excess draw-downs.

Senator NUNN. Is the direct lending going to cover proprietary schools?

Mr. EDELMAN. As far as we understand, they will, if they meet the requirements, be allowed to participate.

Senator NUNN. Have you concluded anything about proprietary schools, short-term proprietary schools, in terms of their uniqueness and whether they ought to be separated from the more traditional higher institutions of education?

Mr. EDELMAN. On the basis of the investigations that we have done over the years both in the student loan program and now our investigations here in the Pell Grant program, in terms of the participation of these short-term proprietary schools, it seems clear that most of the problems are in that sector of the educational community. Moreover, these problems still remain, even after all of our years of hearings at this Subcommittee, even after all of the amendments which Congress has passed to the Higher Education Act, and even after all of the changes which the Department of Education has instituted to deal with these schools. And perhaps it is time to consider whether those programs should be treated in the same way that we treat major colleges and universities, 2- and 4-year degree-granting institutions.

Senator NUNN. Did you find any pattern here of schools that had been primarily getting their students funding from loans? After the

1992 amendments passed and the Department of Education started implementing those and cracking down somewhat on the loan program, did you find a pattern among not just this school, but many schools in moving much more strongly into the Pell Grant program?

Mr. EDELMAN. Well, that was one of the primary concerns that motivated our look at the Pell Grant program, that being that once Congress passed the 1992 amendments, which in many ways tightened up the eligibility requirements for the student loan, that those abusive schools which perhaps saw the handwriting on the wall may get out of loans and then go into the Pell Grant program which, as you stated in your opening, does not have the type of indicators which might alert the authorities to abuse that might be ongoing.

We reviewed Department statistics and found that there very well may be such a pattern. In the 10 years prior to the passage of the 1992 amendments, there were only 80 or 90 schools that left the student loan program and became exclusively Pell Grant programs. In only 2 years following the passage of the 1992 amendments, that number jumped to, I believe, somewhere over 500 schools which left the student loan program and became exclusively Pell Grant programs.

Senator NUNN. So on an annual basis, the number of them converting from loans to Pell Grants went up 300 to 400 percent on an annual basis?

Mr. EDELMAN. That is correct.

Senator NUNN. After the 1992 Act passed?

Mr. EDELMAN. Right, and of those schools that did that, more than half were proprietary schools. So there does seem to be—this is not to say that all of those schools that went from loans to grants exclusively are abusive institutions, but there does seem to be a pattern, and that may be something that the Department perhaps should take into account in making its determinations in terms of marshalling its limited resources for program reviews and audits.

Just to go back briefly to the Inspector General's investigation and its report, we would note that the tone of the investigation report seemed to be in conflict with the initial intention of the Inspector General's office in 1992 to seek termination or prosecution of IADE. It is apparent from Department documents that by December of 1992, the Inspector General's office had changed its mind about IADE. What exactly led to that change, though, is not clear, particularly since the Inspector General's investigation had uncovered what would have seemed to be clear indicators of fraud and abuse.

The Subcommittee staff began its own investigation of IADE in early April of 1994. On approximately April 12 of 1994, the staff spoke with regional department officials about IADE and its sharp increase in Pell Grant funding, and during the week of May 8 through 13, the staff conducted a field investigation in Los Angeles.

On May 17, only 4 days after the staff had concluded its trip to Los Angeles, the Department's Region X office recommended that IADE once again be placed on reimbursement. In a telephone conversation with the staff on May 23, 1994, Frank Dvorak of the Department's Region IX office told the staff that the Department had

put IADE back on reimbursement because of concerns over unresolved findings of the Inspector General's audit. Mr. Dvorak then freely admitted that the decision was made at that time because of the involvement of this Subcommittee in investigating IADE.

On June 29, 1994, IADE, however, was taken off of reimbursement. This time, it appears that the action was taken against the wishes of the Department's program offices. From internal Department documents and interviews with Department employees, it appears that the Department's Office of General Counsel unilaterally agreed to a settlement with IADE under which the school would be taken off of reimbursement in exchange for its establishing a $500,000 letter of credit in the Department's favor. The General Counsel agreed to this settlement despite the fact that the audit report on which the reimbursement action had allegedly been based had found IADE liable for over $1.3 million in improperly disbursed Title IV funds.

Senator NUNN. So, in effect, the Department was owed $1,300,000, but instead of continuing to not allow the school to draw money in advance, to have them reimbursed after the fact, they basically, in exchange for a $500,000 line of credit, put them back on an advance payment basis?

Mr. EDELMAN. They gave them access once again to advance funding for less than $.50 on a dollar.

For the past 5 years, this Subcommittee has been examining the Department's ability to oversee the operation and management of the Nation's federal student financial assistance programs. In hearing after hearing, evidence has been presented documenting problems of mismanagement, incompetence, indifference, lack of resources and training, lack of personnel, and perhaps a lack of will. Time after time, the Subcommittee has heard from Department officials under both Republican and Democratic administrations that they are committed to reforming the process and improving the integrity of the programs they oversee.

Certainly, Congress has attempted to help the Department in this regard. The passage of the 1992 amendments gave the Department a significant tool with which to address the issues of institutional integrity and program fraud and abuse.

Despite the high hopes generated by the Department's new administration, the staff must once again report to the Subcommittee about a massive failure on the part of the Department in carrying out its fiduciary role of ensuring program accountability, a failure which led to over $50 million of taxpayer money going to a school which was little more than a Pell Grant mill. What is most disturbing, however, is that the IADE case seems to be symptomatic of the Department's longstanding and continuing failure to accept its fiduciary obligations and to adopt a consistent and aggressive oversight mentality.

It is not the staff's intention to paint all of the Department's employees with the same brush. There are many hard-working and earnest employees within all levels of the Department who are deeply committed to ensuring the integrity of the programs they administer. The staff spoke with a number of such employees about their own commitment and that of the Department. Unfortunately, the feeling among these employees was unanimous that the De-

partment's approach to enforcement was uneven, inconsistent, and easily susceptible to outside pressures, both institutional and political.

For example, the staff was told that the statutory requirement that institutions submit independent audit reports was "a joke" because the Department consistently had done nothing when institutions failed to submit such a report.

The staff was informed that there are approximately 3,100 schools which have not submitted their required audits, going back in some cases more than 5 years. According to employees interviewed by the staff, until just last year when a new chief of the Audit Resolution Branch was hired, no one in the Department had ever taken responsibility for ensuring that audits are submitted as required.

A number of employees were also concerned about the role played by the Department's Office of General Counsel. The former director of the Compliance and Audit Division told the staff that during her tenure she engaged in numerous battles with senior management and the General Counsel's office over enforcement issues, and that while she ultimately was able to prevail in most instances, she constantly had to defend, argue, and fight for the authority to exercise enforcement decisions. She told the staff that the General Counsel consistently intervened inappropriately in enforcement matters both for and against taking enforcement actions, that it viewed the program staff as incompetent and irrelevant, that it refused to share information on matters in litigation until forced to do so, and that it otherwise attempted to go beyond its role as legal adviser and to control program decisions, particularly those involving settlement matters.

Other employees which the staff spoke with, including the former director of the Institutional Monitoring Division and the former director of the Institutional Participation Division, told the staff of what they perceived to be the Department's failure to apply the laws and regulations governing the student aid programs in a consistent and even-handed manner. They were particularly concerned that senior management constantly sought ways to help schools get off of reimbursement, especially in the face of any overt or implied political pressure.

Mr. Jack Reynolds, the former director of the Institutional Monitoring Division, told the staff that he encountered difficulties in his efforts to apply the Department's certification regulations in an even-handed and consistent manner. As director of the Institutional Participation Division, Mr. Reynolds oversaw the Department's certification and eligibility procedures. He stated that there were a number of times when he had to, "go head to head" with senior management over recertification decisions.

Mr. Reynolds felt that schools which could somehow plead their case directly to senior management, sometimes with political influence, were often allowed to remain certified even when an objective approach would find that they did not meet certification requirements.

The Department managers with whom the staff spoke were unanimous in their view that intense political pressure was sometimes exerted on behalf of certain schools in other areas as well,

by Federal and State officials of both political parties, and that it sometimes succeeded in obtaining preferential treatment for those schools, contrary to the career staff's decisions and contrary to their view of the appropriate enforcement of the law. In particular, it was noted that political pressure appeared to dictate many of the decisions with regard to program reviews, audits, and reimbursement cases.

In addition to a lack of consistency and even-handedness, it was also felt that the Department failed to pursue an aggressive enforcement approach. In this regard, the staff was told of the reassignment of a Mr. Lee Hardwick, the former director of the Institutional Participation and Oversight Service.

Mr. Hardwick was apparently informed by Dr. David Longanecker, the Assistant Secretary for Postsecondary Education, that he was being reassigned because he was "too aggressive," and because he "took this oversight stuff too seriously." Mr. Hardwick confirmed this conversation to the staff.

Staff was also told of other areas in which career employees felt that the Department was going backwards in its enforcement approach. They were particularly concerned about the area of program reviews. Previous Department policy had always been to conduct program reviews with advance notice given to the institution under review. In May 1994, however, the career management within the Institutional Participation and Oversight Service, with the concurrence of the Department's regional branch management, decided to change that policy so that program reviews would be unannounced. As the staff noted in its statement previously, advance notice of various reviews allowed IADE to alter records and engage in activities designed to deceive reviewers.

The decision to conduct Department reviews on an unannounced basis took effect on July 1, 1994. In March 1995, barely 9 months into the new policy, career staff was told by Marianne Phelps that they would be given 1 week to justify the effectiveness of the change or it would be reversed. Given the limited amount of time for which the policy had been effective, it was difficult to gauge its long-term impact. Regardless, Ms. Phelps decided that there was insufficient support for such a policy and it was subsequently reversed. According to the career staff, before the division even had a chance to notify the regional reviewers of the reversal, Dr. Longanecker had already publicly announced it.

The information provided by these individuals is quite disturbing. They are all individuals who took on their positions determined to correct longstanding Department problems. They were charged with development of a plan to do this and it appeared that they were making progress in this area. Indeed, their career records reflect a history of outstanding performance ratings. They had turned the various divisions and branches of the Institutional Participation and Oversight Service into a team that was working together to bring a consistent and even-handed approach to oversight and enforcement.

Each of the career managers with whom we spoke were either involuntarily reassigned or asked for reassignment from their positions. Whether the changes wrought by these managers will continue under their replacements remains to be seen. The fact that

these individuals were either relieved of their duties or felt it necessary to ask for reassignment gives the staff great reason for concern. The staff must therefore question where the Department stands with respect to its responsibilities for program accountability.

Almost 2 years ago, Assistant Secretary Longanecker appeared at this table and, as had his predecessors in previous hearings, assured the Subcommittee that he would strengthen the Department's monitoring and oversight efforts. Unfortunately, we are back here once again with another multi-million-dollar failure on the taxpayers' hands and the same old questions about the Department's capacity and commitment to hold accountable those who would abuse these important programs.

This concludes our presentation, Senator. We do have a bulky exhibit containing numerous documents which we would ask be made an exhibit to the record, and we would be happy to answer any further questions you may have.

Senator NUNN. I think I have asked most of my questions as we have gone along and I think that we had better get to our next panel so we can complete this this morning. I thank both of you for your hard work and all of the other staff who helped you.

Mr. EDELMAN. Thank you.

Senator NUNN. I will call the next three witnesses, Ms. Cornelia Blanchette, who is the Associate Director of Education and Employment Issues, General Accounting Office; Mr. John Higgins, Jr., Acting Inspector General, Department of Education; and Mr. David Longanecker, Assistant Secretary for Postsecondary Education in the Department of Education.

I will ask all of you to hold up your right hands and take the oath.

[Witnesses sworn.]

Before we get started with the testimony of our witnesses here, an announcement. The Subcommittee had planned to call the owners of IADE American Schools. The school was owned by Abraham Stofenmacher and his sons, Bernardo, Alejandro, and Sergio, each of whom was also a salaried officer of IADE. I have been advised by the staff that Abraham, Alejandro, and Sergio have voluntarily absented themselves from reach of service of congressional subpoena. In other words, they are out of the country.

I would further note that the Stofenmachers are Argentine nationals with extensive business interests in Argentina and South America, and with other schools, I am told, going on in those countries. Certainly, it is my hope that the officials in those countries will take note of these hearings and take appropriate action, both civil and otherwise, if there are other actions that are indicated.

Bernardo Stofenmacher, who, in addition to being an owner, was also CEO of IADE, was served with a subpoena and we were hopeful that he would be able to provide valuable information to the Subcommittee as a witness. In response to this subpoena, however, attorneys for Mr. Bernardo Stofenmacher informed the Subcommittee orally and by letter that their client, if called to testify, would assert his constitutional privilege against self-incrimination under the Fifth Amendment and refuse to answer any of the Subcommittee's questions regarding the matter under investigation.

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We also have a practice of usually calling Fifth Amendment witnesses because we have had occasions where they decided to testify even after the Subcommittee had been notified by their attorney that they would assert their Fifth Amendment privileges. We were planning on having him here today to assert his privilege, but we have received medical information from his doctor in writing about immediate medical concerns of his wife, and in light of that we have not compelled his attendance today, since he was also going to assert his Fifth Amendment privileges. Without objection, these letters will be made a part of the record.[1]

Senator NUNN. This Subcommittee always has, and will continue to respect the right of any individual to avail himself of the privileges under our Constitution. Unfortunately, the three remaining family members who owned IADE are outside the jurisdiction of this Subcommittee, as well as the reach of Federal law enforcement authorities at this time. We were unable to locate them after the school closed its doors in March of this year.

In my view, it would be tragic if they never have to answer for their abuses in either a civil or a criminal forum for the kinds of abuses that we have heard documented here today. It is indeed a regrettable commentary that this school was operated by individuals with so few ties to the community they exploited that they could merely leave the country as soon as their misconduct was exposed, and it is particularly tragic not only for the taxpayers, but also more importantly for the students who have been deprived of an education or skill training.

At this point, I will ask Dr. Longanecker if he would like to lead off.

TESTIMONY OF DAVID A. LONGANECKER,[1] ASSISTANT SECRETARY FOR POSTSECONDARY EDUCATION, U.S. DEPARTMENT OF EDUCATION; ACCOMPANIED BY DONALD R. WURTZ, CHIEF FINANCIAL OFFICER

Mr. LONGANECKER. For the record, I am David Longanecker. I am the Assistant Secretary for Postsecondary Education within the Federal U.S. Department of Education. I want to thank you for the opportunity to be here again today, if for no other reason than to help set the record straight.

Obviously, this is a little different testimony than the one I had before. When I last appeared before you, I was basically promising to do something, and today I am here to talk to you about what, in fact, we have done. I am glad to do so, though, because I think we have made substantial progress and I want to have the chance to share that with you.

I am accompanied today by Don Wurtz, who is the Chief Financial Officer of the Department. Don does not have any prepared remarks, but is available to respond to questions that you might have.

I have included my extended remarks for the record, and if it is OK, would have those accepted for the record, but would speak from abbreviated remarks.

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[1] See Exhibits #37 and #38, pages 195 and 197.

[1] The prepared statement of Mr. Longanecker appears on page 114.

Senator NUNN. Without objection.

Mr. LONGANECKER. I would like to address three areas today. First, I would like to describe our substantial efforts over the past 2 years to improve our management and oversight of these important Federal programs. Second, I will identify the areas that need further work. And, third, I will share a proposal to adopt a fundamentally different, and we are convinced, far better approach to oversight that we intend to pursue, hopefully with your assistance.

First, let me describe what we have done to improve these programs and the proof we have that those efforts are working. We are much tougher about letting risky schools into these programs, in the first place, than we used to be. As you can see from the chart that I have provided up there, Chart 1, institutions that apply for recognition in our programs are much more likely to be denied certification than in the past. They are about two-and-a-half times more likely to be denied than was the case in 1990.

Indeed, the more rigorous review appears to be dissuading institutions from seeking recognition, with the average number of institutions applying for recognition decreasing by one-third over the last 4 years. Again, you can see that on the chart.

We are also much tougher about letting risky schools continue to participate in our programs. The share of schools seeking reapproval that are denied has increased dramatically, from 15 percent in 1990 to 23 percent last year. Six hundred institutions, about 8 percent of all of the institutions that currently participate in our programs, have been placed on provisional certification, and we have begun performing recertification reviews of all 7,200 institutions, many of which have not been recertified in 10 to 20 years.

We have added a number of management controls to monitor all participating institutions. We now have one Social Security match—that checks individuals' name and date of birth against their Social Security number—up and running, and another which will help us determine citizenship that is in the process of being developed. That latter one is a response directly to a report of our Inspector General.

We have just recently brought up two major databases, the National Student Loan Data System, which will help us improve not only the management of the loan systems—it has that name to it—but will also help us improve the management of Pell and other student aid programs. We are also bringing up the Postsecondary Education Participant System. Both of those data systems correct concerns that were directly addressed by the GAO report, and both are now up and running. They will be fully populated by the end of this year.

Senator NUNN. Dr. Longanecker, a general question. How much relationship and analogy is there between the Pell Grant program as now administered—I am not talking about the changes you are talking about making, but right now—and the direct lending program that you are about to undertake?

Mr. LONGANECKER. Implementation of the direct lending program has actually helped us improve the management of our other student aid programs because it has allowed us to modernize a number of other areas of the student aid delivery system. This situation arises because we have basically one student aid delivery sys-

tem. So, as we deliver student loans using an improved, systems-enhanced process for determining student eligibility and applying for aid, direct lending is giving us the capability to modify our other computer systems so that they can be as slick, if you will, in providing us the kind of management controls that we have built into that new system that we really need in our other systems.

Senator NUNN. Well, we have heard testimony this morning that students never actually have to sign off on any document, or in this case they didn't, to get Pell Grants—at least no document that is in the possession of the Department of Education. Is that accurate?

Mr. LONGANECKER. They have to sign the electronic Student Aid Report (SAR), but that is not in our presence. They must sign a promissory note for purposes of the student loan program.

Senator NUNN. But I am talking about Pell Grants. Students don't actually have to sign anything that is in your possession that tells you that they know that their Pell Grant money is going to the school?

Mr. LONGANECKER. That is correct.

Senator NUNN. So, in effect, a school that wants to commit fraud can basically make up the names of students and lie to you about what they have got in their file in terms of something that students sign, lie to you about whether the student is in school, and simply get checks from the Government?

Mr. LONGANECKER. If there is fraud and forgery, there is a possibility for that to go undetected. I have learned a great deal today, and I am as appalled by what we are hearing today as you are. It appears that that may well have happened in this case, and that is terrible and we need to find better ways to detect fraud. Yet we have to, I think, remember that we want a system that still is manageable and that gets the funds out to the legitimate providers.

Senator NUNN. Right. That is the dilemma. I understand that.

Mr. LONGANECKER. Yes.

Senator NUNN. But in the loan program, you have to have a note in your file, or the bank does or somebody does.

Mr. LONGANECKER. Yes, there needs to be a signed promissory note.

Senator NUNN. Some independent party other than the one receiving the money—that is, the school—has to have something signed by the student, right, in the loan program?

Mr. LONGANECKER. We receive a signed promissory note in this case. I will get back to you to provide you precisely what is entailed in the case of direct student loans. I would rather not say something that I am not absolutely positive of.

Senator NUNN. It just looks to me on the surface of it, and I will await your answer, that what you have got here is a program where the person who is intended to be the beneficiary never is in the loop on the Pell Grant program in terms of any direct acknowledgement to the Department of Education, either through a note or through a sworn statement, that they indeed are going to receive this education and it is their intent to.

Mr. LONGANECKER. Well, we do review those ESAR's to make sure that they are available, but we don't verify 100 percent of them.

Senator NUNN. And you send the money out in advance?

Mr. LONGANECKER. Yes, that is correct. We send the money out to schools.

Senator NUNN. So the beneficiary of Federal money basically goes to a third party who has a pecuniary interest without the beneficiary ever having been in the loop as far as direct acknowledgement to the Department of Education?

Mr. LONGANECKER. That is correct.

Senator NUNN. It seems to me you need to take a look at that because that removes the whole customer check and balance.

Mr. LONGANECKER. Yes.

Senator NUNN. I mean, in the loan program they have to pay the money back. In the Pell Grant program, you are removing the beneficiary or the client, the one you are trying to help, from the whole process.

Mr. LONGANECKER. One of the projects that I would mention, and that I will be mentioning in a minute, is that we are developing an entirely new computer system for the delivery of our student financial aid that will interrelate all of our databases so that we can follow each student. We are hopeful that via that process we can eliminate the need for advance payment, that we can have a just-in-time delivery which would not have money out there, essentially, in advance, and that would require the appropriate validations. With current modern technology, we ought to be able to achieve that.

Senator NUNN. You would acknowledge that based on what we have heard this morning, a school that can get $58 million in a period of 5 or 6 years at a rapidly escalating rate from the Pell Grant program and people who can remain undetected and leave the country before any penalty is meted out—that is a pretty enticing invitation to anybody who has bad motives around the country or around the world, isn't it? I mean, isn't that a sort of an invitation that we have got an open bank with no security guards and no tellers?

Mr. LONGANECKER. Yes, but I think as I can describe to you, there are pieces of our gatekeeping that are in effect today that would prevent an IADE from occurring today. Now, it is still conceivable that a clever criminal may be able to achieve ill-gotten gains in this program, but I honestly believe that, in this particular case, there are three or four things that we have put in place as a result of our heightened management, and as a result of the amendments of 1992, that would have prevented this.

Senator NUNN. Well, I know computers can do wonderful things and I don't denigrate computer assistance here, and I hope you can update your computers, but it seems to me that somehow or another you have got to put the beneficiary in the loop. That is the ultimate safeguard. That is the ultimate person to complain if they get ripped off. That is the ultimate person that wants the education and is being deprived of it when you basically have a school that takes money and spends it on everything but books and educational materials.

So when you don't have any contact between the beneficiary and the Department of Education, it seems to me you really have removed the ultimate check and balance, if there is going to be one,

other than purely Government rules, regulations, bureaucracy, checks, accountants, all of the mechanisms.

Mr. LONGANECKER. I am not going to argue with your point. That is a very legitimate point, and I think we have some work yet to do on that. I think the proposal that we will lay out here later in my testimony also allows us the possibility of doing some more in that regard.

Senator NUNN. I don't know whether you want to get so computerized and electronically capable that the students don't even ever have to sign a check that is supposed to be for their benefit. It seems like we have gotten that far.

Mr. LONGANECKER. We have gotten that far for the convenience of the schools and to some extent for the convenience of the students. But particularly with certain sectors of the community we are dealing with, perhaps we have gone too far, and I will come back and talk to you about that.

Senator NUNN. I would invite your attention to that area. I don't pretend to have the answer, but it seems to me that the student has got to be in the loop somewhere.

Mr. LONGANECKER. Yes. I would tell you that we also think we have improved by investing a great deal of effort and resources in improving our gatekeeping. We have hired about 100 new staff. We have developed a training academy for them. We have armed them with new technology. All of them have lap top computers with a substantial amount of customized software to help them look at the schools. We have also given them training in how to detect fraud and abuse, which is related to what we are talking about today.

Now, I am concerned about the comments that you received from our staff. I would tell you that I can pretty much imagine who those staff were, and I have a great deal of respect for many of them. They are really superb individuals, by and large. As you might expect, my interpretation of the events that led to their leaving their current jobs is somewhat different than theirs might be. I would rather not go into great detail on that. Those are personnel issues. But I would like to tell you that we are committed. There is not only the ability, but a very strong will to be tough gatekeepers, and I think, as I will show you, that is evident by our performance.

The investment we are making is paying off. As Chart 2 shows you, over 600 institutions have been removed from Title IV eligibility since Dick Riley came to town. That is more than twice the number for the same period before the new administration took office. So, we are denying more institutions, we are getting rid of more institutions, and we are watching those that are in the program much more closely than we were 2 years ago when I last appeared before you.

Yet, we are still preserving access to these programs, with more students receiving assistance today than ever before, even though the number of institutions participating in the program is at a 15-year low. So we think that is good. But as IADE shows—I have to get it right here——

Senator NUNN. You can call it anything you want. I don't know what is correct. [Laughter.]

Mr. LONGANECKER. !ADE demonstrates there is much more to be done. We are totally redesigning our computer system. I mentioned that to you. That project is now slated for completion either late this fall or early next winter, and we are doing more of the same kinds of things that we have done, trying to improve particularly our gatekeeping system. We are doing a great deal of work right now in our Institutional Participation and Oversight Service, looking at reengineering that entire process to improve it.

Senator NUNN. I asked you last time you were here whether you were able to handle the political pressures when you start removing a school from eligibility. I will ask you the same question again. You have removed an awful lot of Title IV participants from the program. Did you get extensive political pressure to not do that from Capitol Hill or anywhere else?

Mr. LONGANECKER. One of the things I have learned is there are a lot of bad institutions in the country, but none are in anybody's congressional district. Yes, we have a lot of involvement with the Congress, but I do not believe we have had unrealistic pressure.

Senator NUNN. Are you withstanding the pressure?

Mr. LONGANECKER. Yes, absolutely.

Senator NUNN. Are you telling people, look, you have got a bad apple here and we are going to get rid of them?

Mr. LONGANECKER. Yes. I think I have shown you evidence to suggest that. I think career staff sometimes don't appreciate that it is entirely legitimate for Members of Congress to represent the interests of their constituencies. So when they call and they ask for us to investigate a concern that they might have, we do that, and on occasion I would tell you that we find indiscretions on the part of our staff. And when that is the case, we will not back up our staff if they have made mistakes.

Where we have a strong case against an institution, we pursue that. We try to be sensitive to the needs of the institutions and to the students and to the Members of Congress that we are working with, but we are going to be aggressive, and I think our evidence in the aggregate and on specific cases would suggest that.

Senator NUNN. So you are not going to leave here in 1½ years and come out with a statement saying you would have cleaned this thing up if it hadn't been for pressure from Capitol Hill?

Mr. LONGANECKER. No, no. I expect to be here again before you in 2 more years, and then 2 years after that.

Senator NUNN. You are able to handle the pressure?

Mr. LONGANECKER. Yes.

Senator NUNN. And you are able to do your job?

Mr. LONGANECKER. Yes.

Senator NUNN. Protecting the taxpayers and the students?

Mr. LONGANECKER. Yes, and I have got a lot of support from my bosses to do that. Let me tell you the way Dick Riley told it to me. He said our administrative excesses should not be the reason that we close an institution, but their administrative malfeasance should be, and so that is what we are looking for. We don't want to essentially impose a system on postsecondary education that makes it impossible for people who want to provide good education to do that. But if they are incapable of doing that, we want to go

after them, and he shared that with me personally. He has met with all of my managers and shared that with them as well.

Senator NUNN. OK.

Mr. LONGANECKER. I mentioned that we are going to continue to try to do a better job. There are some ways in which we could use your help. In the testimony I have provided, the longer version, I have described four areas involving the need for personal financial guarantees, for financial officer liability, for the so-called 85–15 rule, and for liabilities for costs incurred while cases are under appeal.

Senator NUNN. Now, you are saying you are going to try to make the proprietary school people more accountable and you need legislation to do this. When they basically sign up, you want some guarantee for them to put their personal assets behind——

Mr. LONGANECKER. That is correct.

Senator NUNN. Behind what? What is the extent of their liability you are talking about?

Mr. LONGANECKER. Well, we believe that if they have liabilities associated with their involvement in the program, then we think we ought to be able to go after their personal liabilities, as well as their corporate liabilities. It is so easy under the current law to essentially estrange themselves from any responsibility or personal liability.

Senator NUNN. A bank would do that, would they not?

Mr. LONGANECKER. A bank would do that. All we are asking is that we be able to do the same thing that a responsible banker would do.

Senator NUNN. Are you going to have to have a legislative change to do that?

Mr. LONGANECKER. Yes.

Senator NUNN. Have you made a request yet?

Mr. LONGANECKER. No. I am sort of putting you folks on notice today that we will be coming forth in those four areas, and that we will hope to get your help in those areas.

Senator NUNN. Would this just be for proprietary for-profit schools or would this also be for non-profit institutions?

Mr. LONGANECKER. We would only propose that for for-profit institutions. It is really the only place where——

Senator NUNN. Are you going to guard against people switching from profit to non-profit and basically then paying themselves all the salaries—you know, a non-profit can eat up all the salary.

Mr. LONGANECKER. Yes, again, all of these are balancing issues. There are times when it is appropriate for an institution to change its stature. What we have proposed is that when they change from for-profit to non-profit that we put them on provisional certification, and that for a period of 3 years they remain treated as though they were a for-profit institution so that we can see that they just aren't a sheep in wolves' clothing.

Senator NUNN. You are going to do that as part of a legislative change?

Mr. LONGANECKER. Or a wolf in sheep's clothing. I got that backwards, I guess.

Senator NUNN. Can you do that in a regulation?

Mr. LONGANECKER. No, we can't do that in a regulation. We will need some help on that.

Senator NUNN. That is going to take a change in law?

Mr. LONGANECKER. Actually, we have done that in regulation, but we may need some help from you because that is an area where a number of Congress people have raised some concerns about whether we have the regulatory ability to do that. We did institute these measures in regulation, and we believe we have the regulatory authority to do so. If it is challenged, however, we may need some help.

Senator NUNN. Now, you mentioned the 85–15 rule. Over my strong objections, Congress put a moratorium on that last year. Would you explain briefly for those who may not have followed this what that rule is and what the Department of Education's position is on it?

Mr. LONGANECKER. That rule essentially says that an institution must receive at least 15 percent of its revenue from sources other than Federal student financial assistance or it cannot participate in the program. We support that rule. That was a rule that was passed with very broad support initially and then was delayed for a year in its implementation. I might mention as an aside that had that been in place here, we might have been able to come down on this institution last July, but it was delayed for a year.

Senator NUNN. Is the Department going to fight hard?

Mr. LONGANECKER. We will fight for that. We do have a suggestion, though. One of the things that has made it difficult for some people to support 85–15 is that it is possible to have a very constructive institution that serves very poor people and, as a result, might have more than 85 percent of its revenue coming from student financial assistance. So we have suggested that when they go through, if that is a problem, that they add a section that provides for mitigating circumstances for institutions that can prove that they are really serving their students well. We suggested using the same criteria that are in the law for short-term vocational programs; that is, that the institution be able to demonstrate that it has a 70 percent graduation rate and a 70 percent placement rate.

Senator NUNN. And then let the Secretary have a waiver to the normal 85–15 rule?

Mr. LONGANECKER. That is correct.

Senator NUNN. Is that part of another legislative request you will be making?

Mr. LONGANECKER. Yes. Those are all part of the packages that we will have coming forward. Right now——

Senator NUNN. They are not here yet, though, right?

Mr. LONGANECKER. Right now, you don't need that because as of July 1, 85–15 went into effect, and so we have that as current law, and frankly we are comfortable with it. We wouldn't mind that change for mitigating circumstances. If it is challenged, then we will need some help.

Senator NUNN. OK, go ahead. What other changes are you going to be proposing?

Mr. LONGANECKER. Perhaps the greatest significance is that we really believe that we need your help in fundamentally restructuring and improving the overall approach to oversight of these pro-

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grams. We can do some of what we need to do via regulation and simply by changing the way in which we do business, but some will require legislation and we will be seeking your help in that.

What we are proposing is a common-sense approach to gatekeeping. It is a very simple concept. It is based on three very straightforward tenets. As you can see on the chart, the first is that we believe that policy and practice should differentiate between for-profit and not-for-profit institutions, and between degree-granting and non-degree-granting programs.

Experience shows us that fairness can only be achieved if we respect and admit that different institutions are different. You know, we talk about the diversity of American higher education being one of its strengths, and yet we don't allow our policy to respect and reflect that diversity, and we think it only makes sense to do that in our policy.

Second, we believe that the policy and practice should differentiate on the basis of performance. We don't have to worry much about oversight for high-performing institutions, and yet we put them through a great deal of administrative burden because we try to treat all institutions the same. We shouldn't be doing that. We would suggest that we place our oversight, those limited resources we have, on institutions in which Federal dollars in student education are most at risk.

As you can see from Chart 3, our problems are concentrated in the short-term proprietary sector, so most of our attention should be focused on the institutions in this sector. This is just one indicator. This is the default rates, and you can see where the default rates are highest.

Third, we believe that providing better information to students about educational programs and student outcomes will lead to better decisions about where a person chooses to get their education, particularly if that information is provided through honest brokers rather than necessarily by the provider of the education. In our education and training initiative, we have proposed one-stop career centers to provide that information, particularly for students in short-term vocational programs.

So we bring to you a fairly simple story today. We are dedicated to improving the management of these programs. We think our performance demonstrates that, particularly when you consider the management deficit from which we began 2 years ago. The proof of the pudding is in the results. Fewer bad apples are getting in; more bad apples are being eliminated.

We certainly have some continuing work to do. We are dedicated to that improvement. We are going to try to do that through improvements in day-to-day management, and we are proposing this new gatekeeping system that will treat different institutions fairly by treating them differently; that will respect and reward high performance and focus on our efforts on poor performers; and that will provide better information to consumers so that they can make better choices.

I hope we are able to convince you that we are on the right track and that we are dedicated to this. We have the same objective you have—to provide a quality education to students, but to assure that Federal taxpayer dollars aren't wasted in the process. We want to

provide you management of programs that will make you proud of the programs we are entrusted with. Hopefully, we will be able to convince you of that, and I hope to be able to come back in 2 more years and tell you about some more progress we are making.

Senator NUNN. Thank you, Dr. Longanecker. What did you hear this morning on the IADE case that either surprised you or said to you we had better do something about this?

Mr. LONGANECKER. Well, actually, and this may surprise you, most of what I heard today I heard for pretty much the first time in terms of the specifics. I knew the chronology of our involvement, but I didn't know the specifics of the abuses that were occurring, and that is because our Inspector General is very good, in an open investigation, about not sharing anything that he knows. So many times Jack Higgins has said, 'you would be interested, but you don't need to know, Dave,' and so it was very interesting.

Obviously, I was appalled by what I was hearing today. I think it does suggest to us, as we look at the IADE case, that one of the things we need to do better is to have much better collaboration within the Department of Education and between our partners. In fact, as my longer testimony talks about, we are beginning a very disciplined process of working with the accrediting agencies and the States, with the IG's office, the Office of General Counsel, and our own shop internally to make sure that we have the connects that bring us together logically.

Almost all of us, taken piece by piece with one or two exceptions, can defend our actions on IADE, but when you add them together some of the parts don't equal the whole. So they suggest that if we had all known better what was going on—I hadn't heard of IADE until March of this year—we should have had much better collaboration. I think one of the lessons for us, and we have already begun to do this, is to try to provide more matrix management so that we have the connections that are necessary.

Senator NUNN. I will turn to Mr. John Higgins, who is the——

Mr. WURTZ. Mr. Chairman, could I just add one comment to that?

Senator NUNN. Yes.

Mr. WURTZ. You asked with respect to IADE, and I do think the 1992 amendments would have helped us substantially here. I, too, have heard the actual events that took place here and——

Senator NUNN. Speak right into that mike, if you would.

Mr. WURTZ. I, too, just heard the events for the first time this morning of what actually took place there, and as an auditor and a financial person for some 35 years, I find it appalling, frankly. But I do think that the 1992 amendments that require annual audited financial statements—and this is one of the things we never received from IADE, would have detected this fraud. I can assure you that a good audit would have picked this up because all an auditor had to do was say the audit steps for the cash reconciliations, the bank reconciliations, and you start seeing where the money is going, what actually came in, and where it is going out.

You would have started picking this up immediately. You would have confirmed with students, did they attend. That is part of a confirmation process that is normal in financial audits. These are the things we are requiring today take place in the school audits.

Senator NUNN. When did you start requiring that?

Mr. WURTZ. That was required in the 1992 amendments, and the first year they were due was the 1994 year. So, unfortunately, with IADE, in this case their first annual audited financial statement would have been due for their year ended December 31. I believe they were on a December 31 year-end as a proprietary entity.

As testified in the deposition by Mr. Williams, it was obvious that he knew the audit was coming up and that this kind of thing would have been caught at that point in time, and I think they certainly realized the jig was up at that point. So I think we have in place something that is going to give us a better first line of defense on this that will help substantially in this process.

Senator NUNN. Thank you. Mr. Higgins, Acting Inspector General.

TESTIMONY OF JOHN P. HIGGINS, JR.,[1] ACTING INSPECTOR GENERAL, U.S. DEPARTMENT OF EDUCATION

Mr. HIGGINS. Mr. Chairman, I think I want to thank you for inviting me here today to discuss the abuse of the Pell Grant program.

You requested that I provide an update of issues that surfaced in this Committee's 1993 hearings, that I discuss any new issues we have identified since 1993, and that I describe the work that we performed at IADE American Schools in California. These areas are detailed in my written statement which I have provided for the record.

In our 1993 testimony, we explained that by virtue of the program's design, the Department relies on the integrity of the participant organizations and agencies to assure that grant awards are administered properly, refunds are made, and expenditures are accurately reported to the Department. Also, at that time we expressed our hope that many of the provisions enacted in 1992 would serve to strengthen the Department's ability to monitor the performance of participant organizations and agencies.

Mr. Chairman, if I could leave one impression with the Subcommittee this morning, it would be that our hopes have not materialized, in particular, in the gatekeeping area. Legislative changes enacted to ensure satisfactory performance of schools and other Pell program participants are not working as envisioned. The 1992——

Senator NUNN. Are not working as——

Mr. HIGGINS. Envisioned.

Senator NUNN. Are not working as envisioned. Mr. Higgins, if I could get you to pull that mike right up?

You are saying as of right now, they are not working as envisioned?

Mr. HIGGINS. Correct.

The 1992 amendments sought to emphasize State roles and responsibility for Program outcomes by creating State Postsecondary Review Entities which would review the performance of participating schools against measurable performance standards. It appears that this function will not be funded. Therefore, the States' role of

[1] The prepared statement of Mr. Higgins appears on page 126.

overseeing SFA programs falls again with the State licensing agencies, which this Committee recognized in 1990 as being insufficient.

Further, Congress required that accrediting agencies must develop institutional quality standards, such as course completion and job placement rates, to evaluate performance of schools they accredit. Reviews we have conducted at 7 accrediting agencies concluded that accrediting agencies have made little or no progress in developing and implementing the new congressionally-mandated performance standards.

Considering the findings of our reviews, we are concerned whether there will be any meaningful reform in the accreditation process, despite the statutory mandate for accrediting agency standards. Through the SPRE program and increased requirements on accrediting agencies, Congress intended that there be greater measurement of schools' performance in Pell and other Title IV programs. Over the years, we have reported that individuals were trained with a heavy investment of Federal funds for jobs that do not exist.

The current method of funding vocational training requires no consideration of labor market needs and no performance standards for student achievement. This is illustrated by a recent investigation of three cosmetology schools. These schools received $6.7 million over 4 years to educate 4,300 students. Of the 4,300 students, only 80 of them passed the State license exam, at a cost to the taxpayer of $84,000 per license.

Senator NUNN. In other words, there are schools that are getting money that are training people for jobs that don't exist?

Mr. HIGGINS. Correct.

In another instance in which 3,000 students were enrolled at five schools, only 14 percent of the students completed the necessary training and also received a license.

A third legislative fix that appears to have proven less than effective relates to the ability-to-benefit provisions. To be eligible for Title IV assistance, students without high school credentials must pass an approved test. In 1992, Congress authorized the Secretary to approve independently administered tests and to specify the passing score. However, the Department has yet to publish final regulations implementing that provision. Therefore, the issue remains unresolved and the potential for abuse still continues.

Senator NUNN. Mr. Longanecker, when will those regulations be issued?

Mr. LONGANECKER. We are still reviewing those. We actually had that package completed, but could not get it approved through all of our clearances within the administration. While it is unresolved in that respect, we are operating under guidelines that we believe we can enforce and that carry the force of law. So we are working under those guidelines that were published.

Our dilemma is that there are questions about the validity of the approach that is currently existing in law. It is really an area where we probably need to come back and change the underlying law to get something that really talks about ability to benefit.

Senator NUNN. Go ahead, Mr. Higgins.

Mr. HIGGINS. The conversion from clock hours to credit hours as a measure of program length continues to be a problem. By using credit hours instead of clock hours for measuring their programs,

trade schools are able to increase their Federal student aid receipts without adding significantly, if at all, to the instructional content of their courses.

The Department published regulations needed to address this problem. Until recently, these regulations have been enjoined from enforcement. It will now be up to the Department to implement these new regulations.

Senator NUNN. How have they been enjoined? You mean by the court?

Mr. HIGGINS. Yes, sir.

To some extent, the abuse has and will continue during the implementation. This problem will also exist for those schools that have been approved for the conversion until they come up for recertification. That is also at issue.

Through the 1992 amendments, Congress attempted to prohibit the award of Pell Grants to incarcerated students. However, there are loopholes that weaken this prohibition. We found in a recent audit that a school that enrolls prisoners from local and county jails may continue to participate in the Pell Grant program. Unless the Department can address this longstanding problem administratively, additional legislative action will be needed. It does not matter even if they are Federal or State crimes they were convicted of as long as they are sitting in the local jail.

A provision referred to as the 85–15—well, we have already talked about that, the 85–15 rule. I will skip that to speed this up.

The next issue that we also talked about was owner's liability. We are very supportive of what——

Senator NUNN. Let me just ask you on the 85–15 rule, from your perspective as Acting IG, do you think that the 85–15 rule should be left alone by Congress and go into effect as it did on July 1st?

Mr. HIGGINS. I certainly do. We hope that it will not be postponed again. We have written to several Members of Congress on that issue specifically.

Mr. Chairman, 3 years ago the Congress legislated many provisions to strengthen the performance of schools participating in the Pell Grant program, and since that time the Department has attempted to strengthen its monitoring of these schools. However, as I have noted here, many of the statutory provisions are not working as envisioned and it appears that a planned budget reduction will seriously weaken monitoring efforts by my office and, I assume, the Department.

Senator NUNN. You are about to get cut?

Mr. HIGGINS. Yes. We are authorized around the neighborhood of 355 to 360. We are probably going to have to go down to 299 to 310.

Senator NUNN. Are those going to come out of this area? Will those inspectors come out of this area?

Mr. HIGGINS. Yes.

Senator NUNN. Isn't that like leaving the back door open and removing the guards?

Mr. HIGGINS. We think so. This also makes it very important that the issues that I just discussed that are front-end controls be implemented.

In regard to our work at IADE, we performed audit and investigative work in 1992 and 1993. We also are currently conducting a criminal investigation there.

Senator NUNN. You are doing that in connection with Justice or are you doing it where you may turn it over to Justice?

Mr. HIGGINS. No. We are doing it in connection with Justice and the FBI. The first criminal case——

Senator NUNN. Do we have extradition treaties with Argentina?

Mr. HIGGINS. I don't know that we do, but I am sure that they will pursue them, and we will naturally ask them to.

Senator NUNN. Mr. Longanecker, have you contacted the Argentine education authorities about the rip-off that has gone on here?

Mr. LONGANECKER. No, I haven't. I was unaware that this was a group that was operating in Argentina.

Senator NUNN. My understanding is they are operating in more than one Latin American country.

Mr. HIGGINS. Thirty-two countries, I believe.

Senator NUNN. Thirty-two countries they are operating in?

Mr. HIGGINS. That is what I heard, yes.

Senator NUNN. Around South and Central America?

Mr. HIGGINS. Yes.

Senator NUNN. Thirty-two schools?

Mr. HIGGINS. Thirty-two schools, yes.

Senator NUNN. Thirty-two schools in how many countries?

Mr. HIGGINS. I don't know how many countries. I am sorry.

Senator NUNN. It seems to me it would be a good idea to get in touch with—just as a matter of information and courtesy—to let the people wherever they are operating understand.

Mr. LONGANECKER. For the reasons I stated earlier, our knowledge of this particular issue has been somewhat limited, but as we become apprised of that, I will be glad to. I certainly will take that on as one of my responsibilities.

Mr. HIGGINS. The first criminal case was not worked sufficiently and a premature decision was made to close it. Our audit work, although somewhat expanded in scope, found no material evidence of fraudulent activity.

Senator NUNN. Who made that decision?

Mr. HIGGINS. To close the——

Senator NUNN. To close it.

Mr. HIGGINS. The regional Inspector General.

Senator NUNN. Do you think that was a mistake?

Mr. HIGGINS. Definitely.

Senator NUNN. Was that reviewed up the line or was it just a regional decision?

Mr. HIGGINS. That was a regional decision at that time. It is no longer a regional decision.

Senator NUNN. So you have taken steps to change that?

Mr. HIGGINS. Yes.

Senator NUNN. That was a mistake?

Mr. HIGGINS. That was definitely a mistake.

Senator NUNN. Was there any wrongdoing there or was it simply negligence?

Mr. HIGGINS. I wouldn't really say it was negligence. In 1992, we identified the need for 640 people to do the job that we have adequately. Like I just told you before, we have a staff of around 350.

Senator NUNN. So you have got half of what you need right now—you have got about 55 percent of what you need right now and you are being cut some more?

Mr. HIGGINS. Right.

Senator NUNN. Isn't this going to cost the taxpayers money?

Mr. HIGGINS. I personally think it will. Over the years, we have always returned more—we have always gotten back more than our offices cost the taxpayers.

Senator NUNN. I have a great fear that what we are going to see here is cuts in personnel that manage programs with programs not being reduced commensurate with the personnel—in effect, leaving the back door open with nobody there guarding the money, not just in this area but in other areas, too. I mean, I think that is going to be the result of this budget process we are going through.

Mr. HIGGINS. It also emphasizes the need for the front-end controls that are lacking in this case.

Senator NUNN. OK. Mr. Higgins, I have interrupted you. Go ahead and finish.

Mr. HIGGINS. The audit did, however, produce significant results. It found that IADE's improper administration of the ability-to-benefit provision cost the American taxpayer at least $1.3 million in just a 2-year period. The clock-to-credit hour conversion cost the taxpayer an additional $2.8 million for the same time period.

Since conducting IADE activities, we have made management and procedural changes to adjust to difficulties encountered there. Details of these changes have been provided to the Subcommittee in my written statement. I have also provided the Subcommittee in my written statement descriptions of significant investigative cases we have worked since the IADE investigation.

We are convinced, however, that because the Department must rely so heavily on the integrity of the participant organizations and agencies, improving the control of the Pell program will remain difficult. Further, protecting this program from those who, through collusion, abuse the program for personal financial gain will remain problematic unless fundamental changes such as those that I have discussed previously are implemented.

Senator NUNN. Even if we make all those changes, do you think we are going to be able to get this program under control?

Mr. HIGGINS. It will get better. I don't know if it is cost-effective to put in the controls and the people necessary to make it air-tight.

Senator NUNN. At some point, you get diminishing returns?

Mr. HIGGINS. Right.

Senator NUNN. Right now, you have got a program that you are saying is not working correctly.

Mr. HIGGINS. Correct.

Senator NUNN. It is not being properly managed now?

Mr. HIGGINS. Well, I am saying the regulations—there is a need to implement the regulations, and also there is some legislative——

Senator NUNN. You need a change in law?

Mr. HIGGINS. Yes.

Senator NUNN. You need a change in regulations?

Mr. HIGGINS. And the enforcement of the regulations.

Senator NUNN. And you need a change in enforcement?

Mr. HIGGINS. Yes.

Senator NUNN. And you need more personnel?

Mr. HIGGINS. Yes.

Senator NUNN. Is this program something that ought to be saved, or is it going to be a continued rip-off from now on? I am asking your personal opinion.

Mr. HIGGINS. I think it has had a lot of fine results. I think there are a lot of people who got an education who otherwise would not have gotten educations.

Senator NUNN. We just have to accept the rip-offs to some extent?

Mr. HIGGINS. I don't know if we want to accept it or make it more at a level that we can be comfortable with. It doesn't make sense to pay $84,000 for a license to cut hair.

Senator NUNN. At some point, when you have got schools out there that have a profit motive, the more Pell Grants they get, the more money they make. They are in the business to make money, and without the right enforcement you have got no way to regulate that. It is an open purse.

But the other thing that bothers me is if you basically allow them to train 2,000 cosmetologists or 2,000 truck drivers when in that particular region there is only a need for 100, then that is a colossal rip-off in itself even if the training is good.

Mr. HIGGINS. I agree, and we have reported on that issue, actually.

Senator NUNN. But then on the other hand, how do we manage that? I mean, you have got Government money doing that. Without Government money, the market would never dictate that. The market would never dictate that, so the Government is distorting the market by putting the money in it.

On the other hand, how do you regulate that? Are we going to have some central bureau in the Department of Education that starts making economic analysis as to how many jobs are needed and as to what kind? I mean, that gets the Government into a management of markets that is almost—the cure might be as bad as the disease. What do we do about this?

Mr. LONGANECKER. If I might comment on that, Senator, I think some of the proposals and some of the ideas currently being discussed in the education and training initiatives, both from the administration and within the Congress at the present time, try to address that.

The Federal Government doesn't do a particularly good job of manpower planning. Local areas generally do have a fairly good sense of what the local labor market can handle and deal with, and we may need to put in, particularly in shorter-term vocational programs, a stronger requirement for job placement. Placement is a very good proxy for job demands. I mean, if you get placement, there obviously were jobs. So we have placement requirements in our very short-term programs.

Senator NUNN. Why couldn't placement be a big factor in whether the schools get continued eligibility? Why should a school that is not able to place people in jobs for which they were trained—not

able to place a certain percentage of them—be graded on that and if they don't get their placement up to a certain standard be declared ineligible, period? I mean, that is letting the market work rather than the Government trying to decide how many of any particular job we have.

Mr. HIGGINS. That was one of the standards I was talking about when I was talking about the accrediting agencies have not done anything with regard to standards.

Senator NUNN. Do they have that authority already?

Mr. HIGGINS. Yes. It is my understanding that it is their responsibility under the 1992 amendments to develop standards. Now, there is a difference of opinion, I believe, on what we should do with the standards. I am very enforcement-minded and I think the accrediting agencies should be held accountable to those standards and only accredit schools that will meet those standards and continue to meet those standards.

Senator NUNN. Mr. Higgins, you heard the IADE case today. What was your reaction to that, and what steps do you think your office ought to take to address the problems?

Mr. HIGGINS. Well, we have taken several actions. We have replaced the head of the Office of Investigation. Prior to that, we knew that there was a need for the change. We made a change. It just so happens that that change was occurring right within a month of this particular case closing.

We have changed the way we are doing business. We are doing skills assessments with our employees. We had a wake-up call, talked about due professional care. We have developed special training courses down at the Federal Law Enforcement Training Center in Brunswick, Georgia. We have taken a lot of steps, in my estimation, to correct the problem.

Senator NUNN. But you are here telling us that you don't have enough manpower now to do your job and it is being cut. So you are, in effect, saying you are not going to be able to do your job in this area, right, to supervise this and to investigate?

Mr. HIGGINS. I don't think we would ever be able to handle with our current staff level the number of complaints that come in the door.

Senator NUNN. So Congress has got to decide whether to give you enough manpower or just let the rip-offs continue. Is that what you are saying?

Mr. HIGGINS. Yes, sir.

Senator NUNN. Ms. Blanchette, I will call on you now. Am I pronouncing it correctly?

Ms. BLANCHETTE. That is correct.

Senator NUNN. OK.

TESTIMONY OF CORNELIA BLANCHETTE,[1] ASSOCIATE DIRECTOR, EDUCATION AND EMPLOYMENT ISSUES, HEALTH, EDUCATION, AND HUMAN SERVICES DIVISION, U.S. GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY JOSEPH J. EGLIN, ASSISTANT DIRECTOR, HEALTH, EDUCATION, AND HUMAN SERVICES DIVISION

Ms. BLANCHETTE. Mr. Chairman, today I am accompanied by Jay Eglin, who is one of our assistant directors and directs most of our higher education work.

Senator NUNN. I should introduce you as being the Associate Director of Education and Employment Issues, Health, Education, and Human Services Division, General Accounting Office.

Ms. BLANCHETTE. Thank you. I have a longer statement which I will submit for the record, and at this time, with your permission, I will summarize that statement.

Senator NUNN. Good. Without objection, all of your statement will be in the record.

Ms. BLANCHETTE. I am pleased to be here today to discuss the two largest Federal programs that provide financial aid to postsecondary students, the U.S. Department of Education's Federal Family Education Loan Program and its Federal Pell Grant Program. In academic year 1994, these two programs provided over $26 billion in loans and grants to over 10 million students.

Because of the Subcommittee's continuing concern about abuses in Federal student financial aid programs, you asked us to determine the extent to which the Department effectively uses its student aid data to ensure compliance with Federal requirements and prevent the reoccurrence of abuses, and to assess the improvements that the Department plans or has made to its systems for identifying abuses in its loan and grant programs. Our report on the results of our work is being released today. My statement is based on that report. First, I will talk about the Department's use of its FFELP and Pell Grant data, then I will discuss improvement efforts.

Although the Department has, in general, done a good job of providing grants and loans to eligible students, it has been less effective in using available student aid data to ensure compliance with Federal requirements. For example, for fiscal years 1982 through 1992, Department data indicate that 43,000 ineligible students may have received 58,000 loans totaling over $138 million.

For the 5-year period ending in award year 1993, more than 48,000 students may have received Pell Grant overpayments. Further, although FFELP loan defaults have decreased in the past 2 years, the Federal Government paid out over $2.4 billion in fiscal year 1994 to make good its guarantee on defaulted student loans.

The Department's data showed thousands of recurrences of Federal aid abuses that may have been prevented if schools, which are responsible for verifying student eligibility for financial aid under both the FFELP and Pell Grant programs, had available at the time of their determinations data we found in the Department's records.

[1] The prepared statement of Ms. Blanchette appears on page 139

As an example of the specific situations the Department's data revealed, one student defaulted on a loan in May 1992, making the student ineligible for additional student financial aid. According to Department data, however, the student received five additional loans, one in February 1993, two in July 1993, and two in September 1993. Also, according to the data, as of September 30, 1992, of the 43,000 students who were ineligible for additional loans, 20,000 had defaulted on 23,000 loans made to them after they had become ineligible. The amount of principal and interest outstanding on these defaulted loans as of September 30, 1992, was over $56 million.

The Department's data also identified over 100,000 students who, subsequent to having defaulted on a student loan, thereby making them ineligible for any Federal student financial assistance, may have received 139,000 Pell Grants, totaling approximately $200 million. Of these ineligible students, 74,000 may have received one grant, 20,000 two grants, and 7,000 three or more grants.

In addition, the Department's data showed that students may have received loans that exceeded their cost of attendance, Pell Grants from two or more schools for the same enrollment period, and multiple Pell Grants that, in total, exceeded the statutory limit. All of these——

Senator NUNN. Could you go back over the number of ineligible students and the amount of money, and could you give me the time frame for that?

Ms. BLANCHETTE. All right. Our examination covered fiscal years 1982 through 1992, and the Department's data revealed to us through our examination 43,000 ineligible students may have received 58,000 loans totaling over $138 million. With regard to Pell Grants, 48,000 students had received overpayments.

Senator NUNN. That is in a 10-year period?

Ms. BLANCHETTE. That is in a 10-year period for students receiving loans, correct. We also used the Department's data to identify a number of students who were ineligible who had received loans and grants, and had subsequently defaulted on their loans, or received Pell Grants after having defaulted on student loans. The prohibition is against getting further Federal financial aid if you are in default on a loan.

In addition, the Department's data showed that students may have received loans that exceeded their cost of attendance, Pell Grants from two or more schools for the same enrollment period, and multiple Pell Grants that, in total, exceeded the statutory limits. All of these are prohibited practices that schools are responsible for preventing.

The data showed that loans for 2,000 students exceeded cost of attendance by a total of $2.4 million. However, the total instances may have exceeded this because for about a quarter of the data in the system, there was no cost of attendance information. According to the Department's data, during award years 1989 through 1993, over 35,000 students may have received Pell Grants from two or more schools in the same month and year. Department data also showed that 48,000 students attending two or more schools may have received multiple Pell Grants that, in total, exceeded the stat-

utory limit. For example, in award year 1993, one student received grant funds totaling $5,640, when the statutory limit was $2,400.

We realize that these numbers of students and amounts of dollars are only a small percentage of the total number of students who have received loans and grants and the total dollar amount of Federal student financial aid. Nevertheless, we believe our findings are significant because they indicate that the Federal Government could lose large sums of money through erroneous payments to students, some of whom are ineligible for any Federal financial aid.

Because of situations like the ones I have mentioned, the Department has initiated improvements in its student loan and grant systems and program management. These include developing new systems, making organizational changes, and strengthening program reviews at schools. The Department data that I have referred to thus far came from the FFELP database and/or the Pell Grant Recipient and Financial Management System.

The FFELP database was a consolidation of loan data that the Department collected from guaranty agencies annually. The Pell Grant Recipient and Financial Management System is a consolidation of grant data from schools. The FFELP database had limited usefulness in preventing abuses because the data were not provided to the Department until after loans were awarded, sometimes as long as a year afterwards.

In November 1994, the National Student Loan Data System replaced the FFELP database. NSLDS is to be implemented in three phases. It is designed to provide schools on-line access to student loan data and is to be updated monthly. Starting in the fall of 1995, NSLDS, as part of phase II of its implementation, will contain Pell Grant data that will be updated weekly. While NSLDS looks promising, it is too early to determine its effectiveness in ensuring compliance with Federal requirements.

In addition to bringing NSLDS on line, the Department has also made some recent organizational changes to improve the management of its student financial aid programs. When we began our work, there was a lack of full accountability for the effectiveness of these programs because of divided organizational responsibilities. Most notably, there was no unit responsible for overseeing all aspects of the Pell Grant program. Although we have not thoroughly evaluated recent changes, they appear to provide a better organizational framework for program oversight and accountability.

In part, as a result of this Subcommittee's October 1993 hearings and recommendations in the 1993 Office of Inspector General audit report, the Department revised and expanded its criteria for selecting schools for program reviews. In addition, there is now more collaboration between the Department's office that is responsible for monitoring schools and the OIG to help prevent wasted resources through simultaneous uncoordinated and multiple visits to schools. Again, it is too soon for us to assess the effectiveness of these efforts in strengthening program reviews.

In conclusion, the vast majority of student financial aid appears to have been awarded in accordance with Federal requirements, but in some instances the Department has not fully used the data in its systems to ensure compliance. While we recognize that the Department relies extensively on schools to determine students' eli-

gibility for Federal financial aid and to ensure that other requirements are met, we believe that the Department must improve the use of its data to support schools in their compliance assurance role.

A number of improvement efforts have become operational since we used the Department's data to identify the abuses I have talked about this morning. Although, as I have said, it is too soon to assess the effectiveness of these efforts, we commend the Department for moving in the right direction.

Mr. Chairman, this concludes my statement. I will be glad to answer any further questions.

Senator NUNN. Ms. Blanchette, you state that the National Student Loan Data System will be updated monthly in the case of student loan data and weekly in the case of Pell Grant data. Is there any indication that the Department has the capability to routinely review this information to uncover the kinds of payments to ineligible recipients that you describe?

Ms. BLANCHETTE. Of course, the Department certainly has greater capabilities than we have in this regard. We were able to do it with the help of our computer programmers. We had the disadvantage of having to learn the systems, the layouts of the records, and so forth, but we were able to develop computer programs that allowed us to examine the data in the Department's records.

Senator NUNN. You are saying they could do it if they had the desire to do it?

Ms. BLANCHETTE. They could do it, yes.

Senator NUNN. Do they need additional people to do it?

Ms. BLANCHETTE. Well, we didn't look at their personnel in terms of their ability to accomplish the workload. I really can't comment on that.

Senator NUNN. Do you believe they are developing the systems that would allow them to do this?

Ms. BLANCHETTE. They are heading in the right direction. We did not evaluate the new NSLDS, but from what we have been told and what we know of how it is intended to operate, it looks like it will be a big improvement. One of the problems is that the information that is available to schools in terms of defaults and prior abuses is not necessarily available to the schools under the current system, and under NSLDS. There is some delay, a month in the case of loans and a week in the case of Pell Grants.

There is not real-time information available to, in all or some instances, prevent the awarding of additional financial aid. But there certainly is information available to detect patterns in schools that repeatedly award aid to ineligible students and, in that way, prevent recurrences.

Senator NUNN. You also stated that NSLDS is being implemented in three phases. It appears that Phases II and III will include information in the database that will assist in preventing payments to ineligible recipients. Do you feel confident the Department can adequately review and use this data to lower the amount of ineligible outlays?

Ms. BLANCHETTE. Well, as I said, we have not evaluated the new system. It just became operational in November of 1994. The Pell

Grant data will not be added until this fall, and then the remainder of the——

Senator NUNN. So you really haven't done that kind of evaluation that would allow you to answer that question?

Ms. BLANCHETTE. That is correct.

Senator NUNN. Have you looked at the capacity of the Department to handle direct loans?

Ms. BLANCHETTE. We have in general terms. We have not done a detailed evaluation of their implementation of direct lending, but we certainly are aware——

Senator NUNN. What are your personal observations about whether the Department is now prepared to go into the direct lending business?

Ms. BLANCHETTE. Well, this is the second year of direct lending and so far things seem to be going well. The reaction of schools that participated in year one was generally favorable. They did a lot of planning, certainly, in year one to begin implementation, and I guess the real test is when the number of schools increases more and more. Now, this year more schools are coming on line.

Senator NUNN. Have they gone into proprietary schools now?

Ms. BLANCHETTE. Yes, there are proprietary schools included among the schools involved.

Senator NUNN. Mr. Longanecker, is there any selectivity on the proprietary schools that are in direct lending? Are these your most reliable schools with the lowest default rate, or how are you going about that?

Mr. LONGANECKER. In the first 2 years, the criteria did limit the eligibility, but as the program goes into full effect, the criteria for eligibility is, by law, the same as it is today.

Senator NUNN. It is going to be as broad as the Pell Grant program is?

Mr. LONGANECKER. As broad as the current FFEL program is, the current student loan program.

Senator NUNN. Do you approach that with fear and trepidation?

Mr. LONGANECKER. Actually, you know, I think this system is designed in such a way that it will give us more management control, substantially more management control than the existing program. Just to give you an idea, there was a case that they mentioned about the student who had four Pell Grants during a period of time after they had defaulted on a loan. If you did the chronology on that, you would find that, actually, there was no way we would have known that person had defaulted until after all of those Pells had occurred because of the length of time it used to take to reconcile an account before we ever found out about it.

However, in this program, we know when a student is delinquent on their loans right now, and so we can work that into the system, and we have designed our systems so they interface with our other systems. So, in fact, direct lending gives us much more management capability than the existing FFEL program. We are very confident we can do it within existing resources.

Senator NUNN. Mr. Higgins, do you share that confidence that the Department is going to be able to manage the direct lending program based on what you know of the Pell Grant program and what you know of the direct student loan program and what you

know of your personnel situation in the IG office? I am asking your personal view now, not the Department?

Mr. HIGGINS. Well, definitely, this system is improved over the old system. It is a lot less complicated. The Department has given the direct loan people priority hiring, so they are hiring people in that area. We think that if they continue to take it one step at a time and to monitor it closely, it could become very effective.

Senator NUNN. What is the danger here? If you pointed out two or three dangers, what would be the dangers?

Mr. HIGGINS. Moving too fast without the controls in place. We also think it is very important that the gatekeeping process which I spoke to before that is going to keep out the bad players—that is also important.

Senator NUNN. Does the law now permit moving at the kind of pace that would make sure the management systems are in place before you move too rapidly, or is the current course too rapid, in your personal view?

Mr. HIGGINS. I really don't have a view on that. I don't really know enough about it.

Senator NUNN. Has your office gotten involved in doing any IG checks on the direct lending yet?

Mr. HIGGINS. Yes, we are very involved in it.

Senator NUNN. What have you found so far?

Mr. HIGGINS. Well, there is currently a problem in the cash reconciliation area, but they are devoting a lot of time and effort to resolve those problems.

Senator NUNN. Is that the main problem you have found?

Mr. HIGGINS. Right now, yes.

Senator NUNN. What do you mean, cash reconciliation? I mean, that term is broad enough to cover everything we have ever uncovered here, isn't it? [Laughter.]

What happened to the cash? Is that what you are talking about?

Mr. HIGGINS. Well, actually, accounting for it by individual is where the problem is. We can account for it in summary. We can't account for it by individual. Isn't that correct?

Mr. WURTZ. Mr. Chairman, if I may speak to that, the problem is an accounting issue. The individuals that are having the problem are the schools and making sure that they provide the data to our contractor on time so that we can actually, individual by individual, tie in with the cash amount received, and we are doing that by having reconciliations monthly on this.

Some of the bigger schools that use mainframe systems have had difficulty in making the conversion. Actually, the schools that are doing a better job at the present time are those schools where the Department has provided the software for PC operation of the program, and those are able to take it and make easier reconciliations. We are working with the bigger schools on their main frames and helping them to manage this problem. We have people in the field working with it. We have contractors working with it, but we don't see it as a problem of fraud or abuse or anything of this nature. It is a bookkeeping problem at this point in time.

Let me go back for a moment to your earlier question regarding the systems here because one of the problems in managing this

program from the very beginning has been the lack of adequate data.

Senator NUNN. Which program, the existing or the direct?

Mr. WURTZ. The existing program, the FFEL program, the guarantee program, the Pell program. All of that was the lack of having good, accurate data on a timely basis. For example, in the GAO report you look at that and you have got a time frame under that system in which, based on the information we would get under the old data dump from the guarantee agencies, there is no way within 1½ or 2 years that the department would know the student had defaulted under that system.

With the direct loan system, you are going to know immediately because we are handling those loans. So we know when a student is behind not just at the default stage, but when they have missed a payment, so we know exactly what is occurring, at what time, and we can prevent that student from getting a future loan immediately or getting a Pell Grant immediately. That system is almost fully loaded. We are loading all of the information from the lenders this summer. Then we will load the Pell Grant information on this fall and we will have a total system.

This is the largest character-based data system in the country today, so it is an incredible system that we are dealing with, very effective. What it does is gives us information with which to manage, and that is critically important in being able to prevent even things like what happened in the case of IADE by having information currently on time and that is accurate.

Senator NUNN. You have had a lot of problem in the past, though, managing these accrediting agencies, dealing with the States, getting information from the big agencies out there that are managing at a regional level, coordinating your own staff. Now, you are basically going to handle literally millions of loans directly and you believe you are going to have the systems to do it?

Mr. WURTZ. There is a real difference there. Here, we have control. There, we were essentially relying on others, particularly with the information we received from the guarantee agencies and the lenders in the student loan program.

I think that Jack made an extremely important point, though. You know, our data systems are going to be extremely important to us, but the way we manage this program still is only going to be as good as the institutions that we let into the program or that we keep doing honest work in the program, and so the gatekeeping——

Senator NUNN. You had better take it step by step.

Mr. WURTZ. The gatekeeping is something that we have got to make sure is working.

Senator NUNN. Are you going to be willing as a policy matter, Dr. Longanecker, to come over to Congress and say, look, this program can work, but it is going too fast, don't push us? Are you going to be able to do that? Will you be willing to do that?

Mr. LONGANECKER. If that is the case, we would do that because it is very important to the President that this be a successful program. If the President wants it to be a successful program, it will only be successful if we bring it up well. The fact is we have

brought it up well. This program is a model program. We have put our best——

Senator NUNN. You haven't opened it up to all the proprietary schools yet, though, have you?

Mr. LONGANECKER. No. We will, logically, next year, but they have to come through; they have to pass all the other tests. I think when we put together the things the 1992 amendments gave us in our toughened management on the gatekeeping—I mean, more of these institutions are going to be in provisional certification and if we have got problems, we are going to get them out of there, and I think the evidence suggests we are already doing that.

A lot of bad institutions are exiting these programs, and the default rate initiative helped us a great deal in that regard. Once the appeals on the 300 institutions that are still in appeal are resolved, many of them will be gone, as well. So this system is self-cleansing itself a bit and we are helping in that cleansing process, and we are committed to continuing to make it a better overall system.

Senator NUNN. I hope you are right, and we will be pulling for you. I just have to say I have sat in this position through the late 1970's and early 1980's. I have had hearings with the Department of Education, your predecessors coming up, and everything has been said, and your reassurances today I have heard everybody make before.

Then we throw a dart at the board, go out and investigate just about any school—you don't have to be very careful with it, you don't have to get an inside tip—and, bang, you find a huge scandal. Maybe these are aberrations, but I have seen enough aberrations. I think there is a real pattern here.

Mr. LONGANECKER. Well, Senator, I think I am the first one ever to come back to talk to you, and that is partly because I have lasted longer than most of my predecessors.

Senator NUNN. Yes. Why is that? [Laughter.]

Mr. LONGANECKER. Well, I told you before it is probably because I couldn't get a job. I am pretty sure of that now. You know, in my kind of job you don't make a lot of friends, and so I don't think there are a whole lot of other opportunities out there for me.

I do expect to be able to come back and talk to you in a couple of years and continue to show you trends like this, and to be able to also demonstrate to you, to give you examples like IADE where we have found fraud. I mean, in our testimony we identified some areas where we are working together. I don't think the Inspector General's office, the Office of General Counsel, the Office of Postsecondary Education, and the CFO's office have ever worked as closely together as we are today. I mean, we are intentionally forcing ourselves.

Senator NUNN. But you have heard Mr. Higgins say he can't do his job because he doesn't have enough personnel. He doesn't have enough now and he is going to get cut. Now, if you don't have the IG with enough people doing it, how in the world are you going to handle it?

Mr. HIGGINS. Senator, I think the cut that I am talking about happened right up here on this Hill.

Senator NUNN. I understand that, I understand that.

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Mr. HIGGINS. The Department has been very supportive of us as far as our budget request to OMB. They have treated us very well.

Mr. WURTZ. This is certainly an area where we would support—as has been mentioned several times, people keep calling this an honor system, and I would remind the Senator that our tax system is an honor system and the only thing that keeps it honest is to have an adequate audit follow-up where you actually penalize the people that get caught.

Senator NUNN. We have got a $200 billion deficit, too, that has been going on for a long time.

Mr. WURTZ. Absolutely, and we have to be able to deal with that, and therefore we have to catch them. But the cost of trying to put a system in place that would be different from our dependence on the outside auditors, from the schools doing their job—the cost of putting a system in place to do that would be far more than what we are dealing with today.

Senator NUNN. Mr. Longanecker, your career staff was quite concerned over your reversal of their decision to begin conducting program reviews on an unannounced basis. Everything I know about investigative techniques tells me, whether it is IRS or anything else, you have to have unannounced kinds of inspections. Why have you reversed that?

Mr. LONGANECKER. Two reasons. We still do unannounced visits whenever we have a reason to suspect that we need to do an unannounced visit. We don't, however, do all of our reviews unannounced any longer, and there are two good reasons. It just from our perspective, didn't make sense. It costs us a great deal of staff time when we show up on a campus and the people we need to talk to aren't there because they had no idea that we were coming in.

If we have no reason to believe fraud and abuse and if we are looking for mismanagement—and mostly, that is what we are finding in our initial reviews—we can look at those files and it doesn't hurt to have told the schools that we were coming in advance so that they can be prepared to share, so that they can even pull the files and we can give them the instructions. It saves us a great deal of time and efficiency.

Senator NUNN. You are doing that for all schools, though, even those that have high default rates, even for the proprietary schools?

Mr. LONGANECKER. No. If we have reason to believe that there might be a problem beyond the ordinary——

Senator NUNN. At the particular school or in the category?

Mr. LONGANECKER. At that school, at that individual institution.

Senator NUNN. Well, our experience is you can take this proprietary area and throw a dart and you have got a problem.

Mr. LONGANECKER. That is not my experience, and I have worked in this area for a long time. I was the overseer in two States of the private occupational groups that looked at these institutions, and I worked with an awful lot of proprietary schools in both Colorado and Minnesota and I——

Senator NUNN. But your default rates belie that and your placement rates belie that in a lot of areas.

Mr. LONGANECKER. Let me see if I can find a way to say this. A disproportionate share of our problems, without doubt, is in the

proprietary sector, particularly the short-term programs in the proprietary sector, but most institutions in that sector are not bad actors. So, yes, most of the bad ones are in the proprietary sector, but there are still very legitimate providers of service in there and you could make that determination.

Senator NUNN. Well, "most" would be 51 percent.

Mr. LONGANECKER. Yes.

Senator NUNN. Now, are you talking 95 percent or are you talking 51 percent?

Mr. LONGANECKER. No, I am not talking 95. I couldn't give you the percentages, but I tell you, with the things that we have got—high default rates—we are going to go in and check that institution out pretty closely. If we have indications that there is the potential for fraud, we are going to go in with an unannounced visit. But when we are doing a review of Chicago State University, for example, we are probably going to tell them we are coming in, unless we have reason to believe there is fraud occurring.

Senator NUNN. Well, I agree. I think you ought to have certain high-risk categories, though, where you go on unannounced visits. My understanding is you basically terminated anything other than a particular school that you have reason to suspect. That is a lot different than saying, okay, we have got these whole categories out there, the major universities, and we don't need to do it, but we do need to do it in these short-term proprietary schools. I mean, when you eliminate that whole category from unannounced inspections, you are relying almost exclusively on——

Mr. LONGANECKER. That is not what we did. What we said is that we were going to do announced visits unless we had reason to do an unannounced visit.

Senator NUNN. But my contention is you have got reason to do unannounced visits in this whole area called short-term proprietary schools.

Mr. LONGANECKER. Well, we have proposed to you a general approach that would allow us to make much more significant discriminations by type of institution. That is part of our proposal that is before you.

Senator NUNN. Well, does it include this unannounced visit? I mean, you didn't go into any detail today about how you are going to administer this area once you separate them out. I assume that will be forthcoming.

Mr. LONGANECKER. I would not categorize, I think, within that category. I also said that we ought to differentiate by performance, and the best performing proprietary schools ought not be faced with the same broad brush of disrespect and distrust.

Senator NUNN. I don't disagree with that. Where I disagree, though, is saying you have to have one school that has one particular problem before you do an unannounced visit. I do not think that that is the way you have the proper enforcement or the proper investigative techniques. When you have got whole categories out there—it may be 60 schools with high default rates—why shouldn't you have anybody with a high default rate be subject to an unannounced visit?

Mr. LONGANECKER. Well, that is one of the criteria we use to determine an unannounced site visit.

Senator NUNN. Yes, but you are doing it case by case.

Mr. Higgins, where do you come down on this?

Mr. HIGGINS. As far as unannounced visits?

Senator NUNN. Yes.

Mr. HIGGINS. We announce our visits when we do an audit. We don't do it when we do an investigation.

Senator NUNN. You don't do it when?

Mr. HIGGINS. When we are conducting an investigation.

Senator NUNN. You don't feel bound to not have unannounced visits? You do do unannounced visits?

Mr. HIGGINS. Yes, sir.

Senator NUNN. Well, how does that fit into the policy here?

Mr. HIGGINS. I think we have——

Senator NUNN. You have been permitted to continue that, then.

Mr. LONGANECKER. Well, we are permitted to continue that. Our policy still has unannounced site visits. It is just not every visit is an unannounced visit.

Senator NUNN. You have got some staff that you are relying on that you have described as good, honorable people who are very frustrated because of changes being made.

Mr. LONGANECKER. Yes. I think they made a bad decision. I made it very clear to them that I thought that was a bad decision, and they disagreed with me. I will probably make other decisions over the next 6 years that they won't like. I wouldn't be at all surprised with that. But I would tell you I am going to make the decisions that I think are best for the program overall and that will provide integrity to the program and still balance and respect the people with whom we are dealing.

Senator NUNN. Can you assure us that there is not going to be any retaliation against the employees who have been frank and candid in giving their views and opinions to the staff, even though you may disagree with them?

Mr. LONGANECKER. Certainly.

Senator NUNN. Mr. Higgins, I am still trying to understand what you think about this question of unannounced visits, whether it ought to be a policy to do that or whether it ought not be.

Mr. HIGGINS. Generally, when we do a criminal investigation, we do not announce that we are coming. When we do an inspection, we normally do not announce that we are coming. When we do an audit, we do give them prior notice.

Senator NUNN. You are saying "we." You mean the IG department?

Mr. HIGGINS. Yes, sir.

Senator NUNN. Well, what about the other part of enforcement? Do you think on inspections they ought to have the same procedure you have; that is, not to have announced visits on inspections?

Mr. HIGGINS. I think they could do it both ways. I don't think some schools would merit an unannounced visit. Some schools would.

Senator NUNN. But wouldn't there be categories that you ought to basically reserve the right to have unannounced visits?

Mr. HIGGINS. Yes, sir.

Mr. LONGANECKER. I don't think we are talking differently. We have reserved the right to have an unannounced visit of any school.

Senator NUNN. I am hearing different things from your staff and what you——

Mr. LONGANECKER. My staff isn't telling you what the policy is, then. I can tell you that categorically.

Senator NUNN. Well, tell me what the policy is, then.

Mr. LONGANECKER. The policy is that we reserve the right to make any visit an unannounced site visit, but that is not the norm. The norm is that we have announced site visits unless we have reason to believe that there needs to be an unannounced site visit, in which case we will do an unannounced site visit.

Senator NUNN. How far up the line does that approval have to go? Do you have to sign off on any unannounced visit?

Mr. LONGANECKER. No.

Senator NUNN. Who has the authority to do it?

Mr. LONGANECKER. I actually believe that the program review staff have the authority in the regions to determine that. I am not quite sure exactly where that—it certainly doesn't come to me. I have never asked for that level of authority.

Senator NUNN. Well, what kind of proof do they have to have before they can justify going in for an unannounced visit?

Mr. LONGANECKER. They have to make a reasoned judgment, and I expect my staff to do that.

Senator NUNN. How many unannounced visits did you have in 1994? I am not talking about the IG; I am talking about the other departments.

Mr. LONGANECKER. I don't know the answer to that.

Senator NUNN. Can you furnish that for the record?

Mr. LONGANECKER. Yes.

Senator NUNN. And compare it to the previous years?

Mr. LONGANECKER. Sure. Well, in 1994, we will have quite a few because the policy essentially went into effect in 1994.

Senator NUNN. Well, you can trace it with the first 6 months of this year. I would like a comparative.

Mr. LONGANECKER. Yes, we will do that.

Senator NUNN. I would also like to know the level of proof that the staff has to have in order to, or level of suspicion——

Mr. LONGANECKER. I will be glad to provide that and give you a sense of——

Senator NUNN. And who has the authority, if you could clarify all of that for the record.

Mr. LONGANECKER. You bet, yes.[1]

Senator NUNN. Do any of you have any other comments you would like to make? We are going to have to break up here.

Mr. LONGANECKER. The only thing I would say is I think we are on the same team here. This isn't always a lot of fun to come up and have these discussions, but we have learned a lot out of this process and these discussions. We are going to do the best job we can to make you proud of these programs and to make you proud of our management of these programs. We started from a very substantial deficit a couple of years ago and we think we have made a lot of progress. We are going to keep trying, and hopefully that will be more and more evident to you over time.

[1] See Exhibit #39, page 199

Senator NUNN. Well, we look forward to having you come back and give us some, hopefully, examples of how this, particularly in the Pell Grant area, is working. I also would like to get some feedback from you on how we get the student or beneficiary in the loop.

Mr. LONGANECKER. We will do that.

Senator NUNN. Mr. Higgins, do you have anything else?

Mr. HIGGINS. No, sir.

Senator NUNN. Ms. Blanchette?

Ms. BLANCHETTE. No, sir.

Senator NUNN. We thank you all for being here.

I will make one other announcement. I have received a statement from Congressman Bart Gordon of Tennessee on the general subject matter of this hearing. I would note that Congressman Gordon has been very active in Congress' attempt to address many of the systemic problems in Title IV programs. He has introduced legislation directed at remedying the abuses, and we will have his statement as part of the record and available to the media.[1]

Senator NUNN. The record in this case will remain open for 30 days, within which time parties and individuals are invited to submit statements for inclusion in the record.

Thank you.

[Whereupon, at 12:57 p.m., the Subcommittee was adjourned.]

[1] See Exhibit #1, page 145

APPENDIX

STAFF STATEMENT

INTRODUCTION

Mr. Chairman and Members of the Subcommittee, for the past 5 years now the Staff has been reporting to the Subcommittee on its investigation of problems with the management and oversight of federal student financial aid programs. This investigation began with an examination of the guaranteed student loan program. That examination led to a series of hearings beginning in 1990, and culminated in the issuance of a 1991 Subcommittee report which set forth what the Subcommittee termed "overwhelming evidence that the Guaranteed Student Loan Program, particularly as it relates to proprietary schools, is riddled with fraud, waste, and abuse, and is plagued by substantial mismanagement and incompetence."

The Subcommittee's report contained over twenty-five separate recommendations for reform of the loan program. Many of those recommendations were ultimately incorporated into amendments to the Higher Education Act which were passed by the Congress and signed into law by President Bush in 1992. The amendments were designed, among other things, to tighten institutional eligibility and to strengthen the "triad" of State licensure, independent accreditation, and federal certification.

Subsequent to the passage of these amendments, the Staff undertook an examination of the Federal Pell Grant Program. With over $6 billion awarded annually, the Pell Grant Program is the largest direct federal student aid program. The Staff's examination led to hearings in 1993, which revealed that the Pell Grant program was beset by many of the same systemic weaknesses that plagued the student loan program. In particular, the hearings focused on the failure of the Department of Education's gatekeeping and program review procedures to prevent or detect fraud and abuse. These failures were of particular concern to the Staff with respect to the Pell Grant program because, apart from strong and continuous oversight, the Pell Grant program does not contain any structural indicators to alert one to the possibility of ongoing abuse by program participants. Indeed, as the Department's Inspector General put it during the hearings, "the Pell Grant program is by its very design vulnerable to fraud and abuse" because it "operates essentially on an 'honor system'."

The Subcommittee's 1993 hearings concentrated on a number of avocational religious studies schools which managed to gain participation in the Pell Grant program despite their failure to meet normal State licensure and accreditation requirements and the definitional requirements of the Higher Education Act. Once in the program, these schools obtained tens of millions of dollars of federal monies by, among other devices, artificially inflating tuition and drawing down Pell funds for ghost students and otherwise ineligible individuals.

At the same time, the Staff noted during the hearings that the Department's Inspector General had cited a number of proprietary trade schools in the previous few years for similar abuses which also involved tens of millions of dollars. On the basis of this information the Staff conducted a closer examination of Pell Grant abuse within the proprietary trade school sector. The Staff was further spurred in this regard by a concern that as the 1992 Higher Education Act amendments succeeded in tightening program requirements in the student loan area, some problem schools might drift away from the loan program and into the Pell program.

Indeed, a review of the Department's data seems to bear out this pattern. From 1983 to 1992, 95 schools left the student loan program (either voluntarily or involuntarily) and became exclusively Pell Grant participating schools. In the 2 years from 1992 to 1994, 509 schools left the loan program and became exclusively Pell Grant, a 535 percent increase. Of these schools, 271 or 53 percent, were proprietary schools.

Among these schools, one in particular, IADE American Schools, attracted the attention of the Staff and became the subject of our case study. In 1992, IADE, facing the prospect of being disqualified from further participation in Title IV programs as a result of rising default rate on its student loans, voluntarily ceased processing student loan applications for its students. In the 2 years prior to this action, IADE had drawn down slightly under $4 million in Pell Grants. In the 2 years following its cessation of loan activity, IADE drew down a total of almost $25 million in Pell Grants.

The Staff began its investigation of IADE in April 1994. In May 1994, members of the Staff travelled to Los Angeles to interview IADE students, employees, and former employees. Within a matter of days of this trip the Staff uncovered what it believed to be evidence of serious abuses in connection with IADE's participation in the Pell Grant program. Moreover, the Staff's presence at the school resulted in a number of potential witnesses seeking out the Staff to volunteer information as to abuses at IADE.

In the late summer of 1994, the Civil Fraud Division of the Department of Justice began an investigation of IADE. Subsequently, an IADE employee wrote an anonymous letter to IADE's accrediting agency in early 1995 alleging Pell Grant program abuses at IADE. As a result of this letter, the accrediting agency undertook an unannounced site visit to IADE which led to the agency's instituting action in March 1995 to withdraw IADE's accreditation. Faced with the possible loss of its accreditation, an ongoing Justice Department investigation, and the Subcommittee's own investigation, IADE closed its doors on March 13, 1995.

FINDINGS

The Staff's investigation of IADE's participation in the Pell Grant program revealed a pattern which has become all too familiar to this Subcommittee over the years—woefully inadequate training and education, abuse and possible fraud on the part of school officials, and a continuing inability on the part of the Department of Education to deter, detect and pursue such misconduct. Specifically, the Staff found with respect to IADE that:

—many students, including some who could neither read nor write in either English or Spanish, were enrolled in IADE courses in apparent violation of Pell Grant Program ability-to-benefit requirements;

—instruction in IADE courses was woefully inadequate, reflecting the effects of one or more of a variety of problems, including a lack of books and essential equipment, unqualified instructors, and deficiencies in course design and curriculum;

—in the large majority of cases, placement of students who had successfully completed IADE program requirements was completely ineffective and, in many of these cases, school officials deliberately covered up this fact by creating false records and engaging in other questionable practices intended to mislead concerned Federal, State, and accrediting officials into believing that mandatory minimum placement requirements were being met;

—IADE staff and/or corporate officials engaged widely in abusive and possibly fraudulent practices—e.g., altering student financial aid files and computer records, falsifying student signatures on official forms and documents, and falsifying information on course attendance and grade sheets—in order to obtain Pell Grants, for example, for students who had withdrawn from its courses or had enrolled but never attended;

—IADE staff and/or corporate officials deceived and misled Federal and State government officials, as well as accreditation organization representatives, engaged in conducting official reviews of school operations, policies, and procedures; and

—the accountability Triad (i.e., State licensing and oversight, independent accreditation, and eligibility and certification determinations by the U.S. Department of Education) failed to detect, deter, and pursue fraud and abuse in IADE's training programs and participation in the Title IV Pell Grant Program.

IADE AMERICAN SCHOOLS

Prior to shutting its doors earlier this year, IADE American Schools was a proprietary vocational school licensed by the California State Council for Private Postsecondary and Vocational Education, and the Florida State Board of Independent

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Postsecondary Vocational, Technical, Trade and Business Schools. IADE was also accredited by the Accrediting Council for Continuing Education and Training ("ACCET").

IADE opened its first campus in the South Gate section of Los Angeles in 1983. Over the next 5 years the school established four additional campuses in and around the Los Angeles area, as well as a campus in Hialeah Gardens, Florida. IADE catered almost exclusively to the Hispanic immigrant population in both California and Florida. In fact, instruction for many of its courses was provided in Spanish.

IADE is owned by Abraham Stofenmacher and his sons Bernardo, Alejandro, and Sergio Stofenmacher, all of whom are citizens of Argentina. In addition to IADE American Schools, the Stofenmachers own and operate 32 schools in the South American countries of Chile, Paraguay, Uruguay, and Argentina. There is no record with the Department of Education that any of these South American schools participate in any Title IV Student Financial Assistance programs.

IADE's U.S. campuses offered programs of 1 year or less leading to a certificate in computer operations, professional tractor trailer driving, and automobile repairs. Courses in English as a Second Language ("ESL") were also offered. These courses were all eligible for Title IV funding. Additionally, IADE operated a Career Occupational Training Center ("COTC") which offered primarily citizenship courses. The Career Occupational Training Center was not authorized to participate in Title IV programs.

1. Participation in Title IV Programs

IADE became eligible to participate in Title IV Federal Student Financial Assistance programs on August 14, 1989, and has, since that time, participated in the Federal Pell Grant program and two of the Federal Family Education Loan ("FFELP") programs—the Stafford Loan program and Supplemental Loans for Students program. During its initial years of participation, the majority of IADE's students received loans rather than grants.

IADE's first 2 years of participation in the student loan programs resulted in default rates of 33.3 percent in 1990, and 44.6 percent in 1991. As a result, IADE was placed on the Department of Education's June 14, 1993 list of schools with unacceptably high default rates. Under the amendments to the Higher Education Act passed by Congress in 1992, had IADE continued one more year with such a high default rate, it would have been subject to Departmental action which could have terminated its eligibility to participate in any Title IV student financial assistance program. To avoid this possibility, IADE notified the Department on October 6, 1993 of its voluntary withdrawal from all student loan programs. In its letter to the Default Management Section of the Department of Education, IADE stated that it had discontinued processing student loans as of September 16, 1992. Notably, at the same time that IADE was withdrawing from the loan program, its Pell Grant revenue was increasing dramatically.

Indeed, between 1990 and 1994, IADE experienced a phenomenal growth in the volume of its Pell Grant receipts, increasing its drawdown by over 1700 percent. During this same period, the number of Grant recipients grew from 737 to over 9,200. By 1994, nearly all of IADE's students were receiving financial assistance through the Pell Grant Program.

IADE AMERICAN SCHOOLS

Award Year	Recipients	Dollar Amount
1989–1990	737	$ 828,326
1990–1991	2,167	3,226,563
1991–1992	7,192	10,303,302
1992–1993	9,250	14,843,013
1993–1994	10,350	16,563,769
1994–1995	7,298	11,677,015

It seems clear to the Staff that IADE undertook a conscious course of conduct during these years to increase its student enrollment, obtain Pell Grant funding for as many of these students as possible, and maximize the amount of Pell Grant funding for which these students would be eligible. Indeed, in its final few years of operation, IADE's participation in the Pell Grant program was so extensive that it had practically turned into a *de facto* government sponsored enterprise. From 1992

through 1994, IADE's yearly revenue from Pell Grant funding represented between 90–100 percent of its total yearly revenue. At the same time, IADE showed little, if any, interest in providing a quality education for its students or even in ensuring that its students completed the course of studies for which the government was paying.

2. Abuses of Title IV Programs

a. Deceptive Advertising Designed to Attract Students

Our review of IADE American Schools revealed that IADE engaged in a pattern of abusive practices designed to attract low income, poorly educated, immigrant students. In the first instance it did so through the use of a deceptive advertising campaign which offered potential students a "free education."

From 1990 until 1993, IADE spent over $2 million running promotional advertisements for its school on Spanish language television and radio stations in the Los Angeles area. According to former IADE students, this advertising promised potential students a free education which would lead to a high paying jobs in the fields of computers, truck driving or auto mechanics. Because IADE's target audience was comprised primarily of unskilled, uneducated laborers employed in minimum wage jobs and living at or below the poverty level, these advertisements were ultimately quite successful in attracting large numbers of new students.

The Staff interviewed several students who had enrolled in IADE's automotive technician course as a result of these advertisements. Their stories were all quite similar. Jose Quintanilla told the Staff that he had been attracted in 1991 by an IADE advertisement stressing the need for trained automotive technicians and promising job placement in this field. He stated that he went to IADE to obtain more information and was told that he would receive an excellent education through IADE which would prepare him to be a qualified automotive technician. He stated further that he was told that a "diploma" from IADE would enhance his marketability and that employers would require such a diploma.

According to Mr. Quintanilla IADE officials told him that he would qualify for money from the government in the form of grants and loans to cover his tuition. He said that he was told not to worry about being able to afford the payment on the loans because by the time his loans came due he would be earning a significant salary as a result of his training from IADE. Mr. Quintanilla was subsequently given federal forms to sign for his grants and loans, all of which were entirely in English. Mr. Quintanilla was not provided with a Spanish translation, despite the fact that he understood very little English and all of his previous discussions with IADE officials had been conducted in Spanish. Mr. Quintanilla stated that he had no understanding of the significance of the forms at the time he signed them.

Miguel Garcia also enrolled in IADE as a result of the school's advertising campaign. He stated that when he went to the school for an interview he was promised that upon completion of his training he would be given a set of mechanic's tools and placed in a job at $15 per hour. He was then given papers to fill out and sign which he was told were for a government grant to pay for his tuition. As was the case with Jose Quintanilla, Mr. Garcia had no real understanding of the papers he was signing because of his limited command of the English language. It was only after he had completed his courses at IADE that Mr. Garcia learned that he had signed applications not only for a Pell Grant but for a guaranteed student loan as well.

b. Ability to Benefit Testing Manipulated to Maximize Enrollment

As stated previously, IADE focused its recruitment efforts on the immigrant Hispanic population of the Los Angeles area. Most of the potential students IADE attracted had limited formal education; indeed, many had not even graduated from high school. In accordance with the provisions of the Higher Education Act, IADE was required to determine that these students had the ability to benefit from the training offered by IADE before it could obtain federal financial assistance on their behalf. Under rules instituted in 1991, this determination was to be made on the basis of an independently administered examination approved by the Secretary of Education.

IADE manipulated the ability to benefit testing process in both blatant and subtle ways in order to maximize the number of students eligible for financial assistance. In some cases, IADE simply ignored the results of the testing and admitted students regardless of their performance. For example, Jose Quintanilla told the Staff that he was given an ability to benefit test by IADE. He stated that he knew some of the answers on the test, but that he had not had enough time to complete more than twelve of the test's fifty questions. Despite not even answering over 75 percent

of the test's questions, Mr. Quintanilla was enrolled in IADE the following day. He candidly told the Staff that he did not understand how he had passed the test.

Perhaps Miguel Garcia's experience explains how Mr. Quintanilla managed to pass his test. Mr. Garcia was also administered an ability to benefit test by IADE. According to Mr. Garcia, a test proctor told him that all he needed to do was to sign his name on the test form and that any unanswered questions would be filled in for him later by the proctor. Mr. Garcia also told the Staff that he saw individuals taking the test who were illiterate not only in English but in Spanish as well. He recalled seeing one individual sign his name on the test with an "X." Mr. Garcia said that he subsequently saw some of these people in IADE courses.

Mr. Garcia's story was confirmed by countless other students and even former employees who told the Staff that IADE admitted students who could neither read nor write and who clearly lacked the skills necessary to benefit from the training offered by IADE. One IADE instructor told the Staff that close to half of the students registered for his automotive mechanics class could not read or write well enough to benefit from the instruction. He stated that some of his students had told him that they had merely written their names on the ability to benefit test and that the rest "was taken care of" by IADE sales or admissions representatives. Another former IADE instructor told the Staff that he had overheard two of IADE owners saying that the school needed to enroll twenty to thirty new students per week and that whatever had to be done to get them enrolled would be done.

In addition to completing tests for students, IADE also engaged in more subtle means of boosting the number of students admitted on the basis of ability to benefit testing. One of these means was the use of artificially low cutoff scores for determining whether a student had passed the ability to benefit test. IADE used an ability to benefit test developed by E.F. Wonderlic, Inc. which was originally designed to be used by employers for evaluating job applicants. The cutoff scores established by Wonderlic were therefore set for this purpose and not for the purpose of determining ability to benefit from training programs.

Wonderlic subsequently distributed its test to postsecondary vocational schools such as IADE for ability to benefit testing, advising the schools to use whatever minimum passing scores were indicated from their experience in using the test. Wonderlic told the schools, however, that it expected that a school which deviated from the suggested cutoff scores would have support for such deviation. In 1990, Wonderlic did establish a separate set of cutoff scores for use by postsecondary vocational schools. Those scores were further revised in 1991 to comply with Department of Education standards. The cutoff scores as revised are shown in the following chart:

Vocational Field	Prior To 5/90	5/90 To 7/91	After 7/91
Computer Office System Specialist	21	16	15
Automobile Technician	19	14	13
Professional Tractor Trailer Driver	18	15	13
Security Guard	14	11	10
English as a Second Language	10	10	10

IADE established a cutoff score of 10 for all vocational fields, far below that suggested by Wonderlic. The school defended its cutoff score on the grounds that: 1) prior to 1991, federal laws and regulations did not mandate scoring standards for ability to benefit tests; 2) Wonderlic's cutoff scores were only guidelines and not requirements; and 3) the cutoff score of ten was developed based on racial/ethnic conversion data published by Wonderlic.

While IADE is correct that scoring standards were not mandated prior to 1991, it was required at that time to comply with any applicable criteria for ability to benefit scoring established by its accrediting agency. In this case, IADE's accrediting agency, ACCET had instructed its schools that deviations from test publishers' guidelines would only be allowed with written permission of the publisher and written concurrence of the ACCET accrediting commission. IADE had obtained neither.

IADE's reliance on Wonderlic's conversion data is similarly misplaced. Wonderlic's Vice President Eliot Long told the Staff that the ethnic conversion data was not intended to be used in an assessment of a potential student's ability or likelihood of successful performance, but rather was intended in assessing job candidates. He further told the Staff that any use of this data outside of the employment area would be incorrect. Moreover, the fact that IADE administered the Wonderlic exam in Spanish as opposed to English mitigated against the need for using any conversion

data on behalf of Hispanic students. Mr. Long pointed out that Wonderlic recommends using the same minimum passing score for students tested on the Spanish language version of the test as for those tested on the English language version.

The issue of IADE's artificially low cutoff scores was noted by both IADE's own independent auditor and the Office of Audit of the Department of Education's Inspector General's office. In a March 30, 1992 audit report, IADE's auditor noted that twenty percent (twenty-one out of 101) of a sample of student files drawn from IADE's records revealed students who had failed to achieve the test publisher's minimum passing score on the ability to benefit test. On the basis of this finding, the auditor recommended that IADE review all student files to determine whether students admitted on the basis of ability to benefit testing had in fact achieved at least the minimum passing score on the test.

In a September 1993 audit report, the Inspector General found that IADE was unjustified in using its low cutoff scores on ability to benefit testing. On the basis of this finding, the Inspector General determined that the school had improperly disbursed over $1.2 million in student financial assistance during the period July 1, 1989 through March 4, 1992. Of this figure over $845,000 represented improperly disbursed Pell Grants.

As a result of IADE's manipulation of ability to benefit testing the school ended up with a student population the vast majority of which was comprised of ability to benefit students. Indeed, in a 1992 review of IADE's ability to benefit program, the Accrediting Council on Continuing Education and Training ("ACCET") noted that nearly 100 percent of IADE's students had been admitted on this basis. In 1992, however, Congress amended the definition of "eligible institution" contained in the Higher Education Act to provide that an otherwise eligible institution that does not offer programs for which at least an associate or bachelors degree is offered, loses its eligibility if more than 50 percent of its students are ability to benefit students. If ACCET's review was correct, then IADE's continued eligibility to participate in student financial assistance programs would have been thrown into doubt as a result of this amendment.

When the Staff raised this issue with Ken Williams, IADE's former Director of Financial Aid, he disputed ACCET's findings. He did, however, agree that IADE would have had a very difficult time meeting the 50 percent requirement. He in fact admitted that the majority of students at IADE were ability to benefit students, though he put the figure at probably closer to 60 percent than 100 percent. Both a former financial aid director and a former program director at one of IADE campuses presented a different picture, though, from Mr. Williams. These officials told the Staff that they saw very few students admitted to IADE who were not ability to benefit students. Other former directors and employees at IADE told the Staff that accurate figures on ability to benefit students were not available.

The CPPVE, IADE's State licensing agency, was also concerned about this issue. In 1993, the CPPVE directed IADE to provide an accurate accounting of its ability to benefit students and a description of the procedure to be established to derive this accounting. IADE never complied with this directive.

IADE's manipulation of the ability to benefit testing apparently continued throughout its existence. In an interview with Eliot Long, Vice President of Wonderlic Personnel Test, Inc., the Staff learned that as recently as January 1995, Wonderlic had terminated the registration of eight test administrators from IADE and had placed another four on probation after finding irregularities that were inconsistent with proper test administration and scoring.

Mr. Long explained to the Staff that Wonderlic conducts an annual review of each Independent Test Administrator's registered test scores. When it did such a review for IADE's administrators, Wonderlic found many had abnormally high passing rates. This prompted Wonderlic to schedule an on-site audit of IADE's test records.

Wonderlic sent auditors to each of IADE's six locations in the Los Angeles area. These auditors reviewed approximately 200 selected test records at each site. These records were of students who had graduated, dropped out, withdrawn, and were no-shows. Mr. Long said the purpose of this audit was to look for patterns of irregularities rather than problems with individual records.

The auditors confirmed that there was an exceptionally high passing rate for tests administered by certain test administrators at IADE. In particular, the Wonderlic auditors found that a large number of tests had been age adjusted, resulting in an unusually high percentage of students passing the test solely on the basis of the age adjustment. Of those who passed with scores significantly above the minimum, few had been age adjusted. Based on the age of the IADE student population and established norms for age adjustment, Wonderlic determined that IADE was misreporting the age of a significant number of its students.

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The auditors also found that a significant number of the tests appeared to have more than one person's handwriting on it. For example, the auditors found signatures that did not match the handwriting on the answer sheet and answers on a number of different test sheets which appeared to be in the same handwriting. As a result, Wonderlic charged that someone other than the student had completed the test in order to insure a passing score.

Lastly, the auditors found that test administrators at the Oxnard campus were giving classes on how to take tests, such as the Wonderlic Ability-to-Benefit test, prior to administering such tests. Administrators were also suspected of providing the answers to the Wonderlic test during these training sessions.

As a result of these findings, Wonderlic terminated the registration of eight IADE independent Wonderlic Test Administrators and suspended the registration of four. Mr. Long told the Staff that IADE did not contest any of Wonderlic's findings.

c. Calculation of Course Length Manipulated to Maximize Amount of Pell Grants for which Students would be Eligible

In addition to attempting to maximize the number of Pell eligible students it enrolled, IADE also attempted to maximize the amount of Pell Grants for which these students would be eligible. Only a few months after IADE first began participating in Title IV programs, the school changed the method by which it measured the length of its courses. The result of this change was to make IADE eligible to receive more than twice the amount of Pell Grants it otherwise would have received without this change.

In its initial application for institutional eligibility and certification in September 1989, IADE measured its courses in terms of clock hours, with various programs ranging anywhere from 180 clock hours for a program in electronics technology to 700 clock hours for a program in automobile electricity, tune-up and brakes technician. Under provisions of the Higher Education Act in effect at that time, short term programs of less than 600 clock hours were eligible to participate only in the guaranteed student loan program. As a result, many of IADE's programs were not eligible to participate in the Pell Grant program. By converting from clock hours to credit hours, IADE was able to suddenly make many of these programs Pell eligible. The conversion from clock hours to credit hours also enabled IADE to collect even greater amounts of Pell funds for those of its programs which already had been Pell eligible. When the Staff discussed the conversion with officials from ACCET, IADE's accrediting agency, they readily admitted that except for the increased access to student financial assistance, there was no other benefit in IADE's switching from clock to credit hours. Indeed, even IADE's former Financial Aid Director admitted to the Staff that the only reason for the conversion was to obtain more Pell funds.

At the time IADE undertook this action there was no federally mandated formula in effect for converting from clock to credit hours. The Higher Education Act did define an academic year as consisting of 900 clock hours or 24 credit hours. By implication, one could thus presume that 37.5 clock hours equalled one credit hour (i.e., 900/24 = 37.5); however, this formula was not explicitly required until just last year. In the absence of any federal formula, IADE converted its clock hours to credit hours using a formula provided by its accrediting agency, ACCET. This formula provided that fifteen hours of classroom instruction was equal to one credit hour.

Using this formula, a 300 clock hour program, which previously would not have been eligible for Pell funding, became a 20 credit hour program which was Pell eligible. Moreover, a 700 clock hour program, which previously would have been completed in the span of just one Pell award year, became a 46.6 credit hour program, thereby stretching over two Pell award years. The Department of Education approved IADE's conversion in March 1990, despite the fact that only the month before the Department's Inspector General had issued a Management Improvement Report highlighting the abuses in this area and stating that instead of relying on accrediting agencies to limit the abuses, the Department needed to take more direct action itself.

d. IADE Failed to Provide Students with a Quality Education

While IADE apparently expended much time and effort on maximizing the amount of Pell funds it could obtain, it seemed to spend little time or effort on providing its students with a quality education. Indeed, the only time IADE seemed concerned with its students' education was when it had to demonstrate the nature of that education to State, federal or accrediting agency reviewers.

The Staff interviewed numerous students and instructors concerning this issue. The common thread running through all of these interviews was the poor quality of the education offered by IADE. While the Staff found many dedicated instructors

working at IADE, their efforts were consistently undermined by IADE's owners and senior management.

Arnoldo Sanchez, IADE's former Curriculum Coordinator, told the Staff that the training students received in the automotive technician program was clearly inadequate to qualify them for a job as an auto mechanic. He explained that there typically was not enough equipment at the training sites to enable students to obtain the necessary hands-on experience. As an example he cited a course given at IADE's South Gate campus which had only two oscilloscopes for a class of more than twenty students, a ratio of students to equipment of more than 10-to-1. Mr. Sanchez noted that IADE's accrediting standards required that there be no more than a 5-to-1 ratio of students to equipment.

School officials covered up this deficiency during reaccreditation site visits by telling the accrediting team that students were trained on this equipment in groups of five. This, Mr. Sanchez stated, was a lie. In fact, according to Mr. Sanchez, the lack of sufficient equipment meant that students did not receive training adequate to teach them how to use the equipment.

Other students and instructors confirmed Mr. Sanchez's comments. The Staff was told that automotive technician classes often consisted of more than two dozen students crowding around a the engine of a single car, making it nearly impossible for each student to see the part of the engine being worked on. Students stated that IADE often did not even provide engines for students to work on, necessitating that students or instructors bring in their own cars in order for students to obtain hands-on experience. One instructor told the Staff that his students had tried to talk him into bringing in his car so the students could work on it in class. He stated that he refused because he was not confident enough of his students' abilities to let them work on his own car. An IADE student with whom the Staff talked was not so smart. He was convinced to bring in his own car for his fellow students to work on in class. He told the Staff that in the course of learning how to fix cars they so ruined his car that it never ran properly again.

Once again, however, when the time came for IADE's reaccreditation site visit, the school suddenly obtained a new engine for its students. Unfortunately, none of the students was allowed to train on the engine. Indeed, they were told they were not even to touch it. When the accrediting team left the campus, so did the engine.

IADE's efforts to spruce up for reaccreditation visits were evidently quite blatant. A Department of Education IG investigator told the Staff of accompanying officials of the CPPVE on an unannounced site visit to IADE. The investigator stated that at the time they arrived they found IADE in the midst of preparing for a reaccreditation site visit. According to the investigator, as they walked around the school's campuses they noticed that additional equipment was "coming out of the woodwork." Strangely enough, though, the investigator apparently took no action to inform the accrediting agency of her observations; nor did she refer the matter for further follow-up by the IG itself. The reasoning the investigator gave the Staff for this was that she had only been at IADE to act as an interpreter for the CPPVE officials and had not been there in an investigative capacity.

The problems experienced in the automotive classes were also prevalent in other courses of instruction at IADE. A former accounting instructor told the Staff that it was extremely difficult to teach proper accounting when the only equipment he was provided by the school consisted of a $5 software disk without documentation. The Director of IADE's English as a Second Language program told the Staff that she was unable to obtain textbooks for most of her courses. She stated that she improvised with newspapers and magazines, but that many other ESL teachers simply refused to teach without books. As a result, students would go for weeks without any instruction. Many students quit because of these problems. It was only toward the end of the course that the ESL classes were finally given materials. These materials, however, consisted of only photocopies of textbooks.

A former Computer Operations instructor told the Staff that the computers used in his classroom were outdated and often in non-functional condition. He stated that days often went by before the computers would be fixed and that during that time there were no back-up machines to continue the students' training.

The instructor also said that there was no written curriculum for the computer class until just prior to IADE's 1992 reaccreditation site visit. In anticipation of the visit, curricula were hastily prepared and instructors were briefed by Bernardo Stofenmacher, one of IADE's owners and officers, as to what to say and how to respond to the accrediting team members.

e. IADE Failed to Provide Students with Adequate Placement Services

In addition to failing to provide its student's with a quality education, IADE also failed to provide them with adequate placement services. In contrast to its enticing

advertising claims of over 70 percent placement and its promises to students of jobs with beginning wages ranging from $7 to $15 per hour, IADE did little to assist its students in finding employment in the fields for which they had trained. To hide this fact from accreditors and regulators, IADE engaged in a pattern of deception and falsification designed to make it appear that minimum placement requirements were being met.

In March 1992, ten former IADE students sued the school for breach of contract, false advertising, intentional and negligent misrepresentation, and unfair business practices. All the students had been in IADE's automotive technician program in 1990 and 1991. All had been promised job placements by IADE officials at wages starting at $7 to $8 an hour. Although the students discovered during the course of their lawsuit that IADE's records listed them as having been placed, none had been able to secure a job as an automotive technician. According to the students, IADE's job placement service consisted of escorting the students to the local unemployment office.

Students in IADE's Truck Driving and Computer Systems programs also complained about failed promises with regard to placement. They stated that IADE offered them no placement assistance and would not even return the phone calls of students who sought assistance. Most of these students were either unemployed or employed in areas unrelated to their training. Indeed, a review of a random sample of the placement records of students in these programs showed the following results:

Graduate/Program	Job Title/Responsibilities
Edin, Computer Operations	pit boss in a casino (hired before IADE training)
Gabriel, Truck Driving	pipe fitter's helper
Jose, Computer Operations	packs bags
Veronica, Computer Operations	retail clothing store
Hector, Truck Driving	manages property
Carlos, Truck Driving	construction development
Yolando, Computer Operations	shipping and receiving
Jesus, Computer Operations	bartender
Everardo, Computer Operations	shipping clerk

IADE's poor placement services almost led to the school losing its accreditation in July 1992. During a reaccreditation site visit that year, ACCET not only found IADE's placement services to be "deficient," but stated that "the results of its placement efforts are detrimental to its perceived integrity and stature in the community." According to ACCET's report, IADE failed to follow the accreditation agency's policies with respect to its placement services. Of the seven IADE branch campuses reviewed by the reaccrediting team, one received a rating of "2" out of a possible "4" in this area, signifying that the branch was "weak" and needed some changes to meet the agency's standard. The remaining six each received a rating of "1," signifying that those branches' policies were "unacceptable" and that "major changes [were] needed to meet the [agency's] standard."

Partly as a result of IADE's problems with placement services, ACCET deferred granting IADE reaccreditation until April 1993, pending receipt of additional information and a follow-up visit to all branch campuses. When those follow-up visits took place in March 1993, the ACCET reviewers found what they termed a "dramatic turnaround" from the placement statistics reviewed in the previous site visit. What the reviewers did not know, however, was that this dramatic turnaround was the result of an elaborate pattern of deception directed by the highest levels of IADE's management.

Maria McFarlane, a former IADE placement counselor, informed the Staff of what she called a virtual "dirty tricks" crew—almost all of whom were illegal aliens—which was used by IADE to falsify and inflate placement statistics. According to Ms. McFarlane, eight to ten IADE employees were sent to the local courthouse to obtain the names of companies which had filed for bankruptcy. These companies were then cited in IADE's records as locations where students had been placed, with the full knowledge that there was little chance that any verification could be done.

Arnoldo Sanchez, another former IADE employee, told the Staff of other methods utilized by Bernado and Sergio Stofenmacher to falsify placement data and deceive the reaccrediting team in connection with ACCET's follow-up visit. According to Mr. Sanchez, he was directed by Sergio Stofenmacher to disconnect one of IADE's FAX machines and to answer that number as if it were a place of business. Another IADE employee then gave the ACCET reviewers the number, telling them that it was the number of a business which employed IADE students. When the reviewers

called the number, Sanchez answered and "confirmed" that the particular student in question worked there.

Mr. Sanchez told the Staff that during the follow-up visit "everything was a show" designed to cover up IADE's problems and to fool ACCET's reviewers into believing that IADE had come into compliance with the accrediting agency's requirement's. For example, Mr. Sanchez stated that IADE gave the ACCET reviewers copies of letters purporting to show how the school had attempted, albeit unsuccessfully, to contact students regarding placements. These letters, however, had been deliberately sent to addresses where the students did not reside solely for the purpose of being able to claim that attempts had been made to place students. Another employee told the Staff that placement coordinators were directed to tell automotive students to become independent contractor mechanics. In this way the school could list the student as a successful placement.

IADE officials also attempted to deceive the Staff concerning its placement record. In the course of the our investigation, IADE official's provided the Staff with thirty-six letters purporting to be from employers of IADE graduates. When the Staff attempted to contact some of these "employers," however, we found quite a different story. Of the employers the Staff reached, four had heard of IADE, but stated that they had never hired anyone from that school; moreover, they did not recall ever sending IADE a letter stating otherwise. One employer stated that he not only had not hired anyone from IADE, but that he had never heard of the manager who purportedly signed the letter on behalf of his business.

Of those employers which did confirm having hired IADE students, one was a gas station owner who told the Staff that the person hired had not worked out because he could not speak English. An owner of an import/export company told the Staff that he had an IADE student working for him, but stated that he had employed the student before she decided to go to IADE. The owner of an oil changing center informed the Staff that he had hired three IADE automotive technician graduates. He stated that they were well trained to change oil and transmission fluid and to lubricate a chassis, but that that was about all they could do.

f. IADE Falsified Student Records Both to Obtain Pell Grants and to Avoid Making Required Refunds of Pell Grants

The Staff's investigation has also revealed that IADE engaged in widespread pattern of altering student financial aid files, including the forgery of student signatures on official forms and documents and the falsification of information on course attendance and grade sheets. These actions were consciously undertaken for the purpose of obtaining Pell Grants for students who had never enrolled at IADE and of avoiding making required refunds for students who had enrolled but had subsequently dropped out. As a result of these actions, IADE improperly obtained, and retained, millions of dollars in federal student financial assistance funds.

The Staff discovered that numerous students who had merely inquired about IADE's programs without ever enrolling unwittingly became "students" in IADE's records for whom the institution received multiple Pell Grants. Such is the case of Maria Arana. On February 1, 1994, Ms. Arana went with a friend to the Santa Ana campus of IADE to inquire about taking computer courses. When she arrived at the campus, Ms. Arana was introduced to a woman named "Anna" who told her that she could take both English classes and computer classes at IADE and that she would be eligible to obtain financial assistance to pay for these courses. Ms. Arana was told that all she needed to do to obtain this assistance was to provide Anna with her tax return, a driver's license, and a passport. Ms. Arana gave these items to Anna and was then taken to another location to take an English placement examination.

When Ms. Arana returned from taking the English examination she was given a series of forms to sign. She confirmed to the Staff that one of these forms was the Free Application for Federal Student Aid (the "FASA"). Ms. Arana commented to the Staff that she had thought it odd that the FASA was already filled out with her financial information because she had not yet told anyone that she intended to enroll.

In fact, Ms. Arana decided not to enroll at IADE. She told the Staff that she felt that Anna had been too pushy and that she seemed more interested in getting her to sign forms than in explaining to her what IADE had to offer. Despite Ms. Arana's decision not to enroll at IADE, it appears that IADE nevertheless "enrolled" Ms. Arana.

The Staff examined IADE's student records and found Ms. Arana's name on a list of no-show students whose enrollment date was February 1, 1994. Giving IADE the benefit of the doubt, it is possible that among the various forms she signed the day she visited IADE, Ms. Arana may have unwittingly signed an enrollment contract.

89 BEST COPY AVAILABLE

It thus would not be inappropriate for Ms. Arana's name to show up on a list of no-show students, particularly given Ms. Arana's statement to the Staff that she did not, in fact, attend IADE.

An examination of IADE's Master Sheets, however, uncovered additional information relating to Ms. Arana which was quite disturbing. Master Sheets are documents maintained by IADE for each enrolled student. The Master Sheet shows, among other things, the particular classes the student has taken, whether the student has maintained satisfactory progress, and the date and amount of any financial aid received.

The Staff discovered that included among IADE's Master Sheets was one for Ms. Arana. This Master Sheet recorded Ms. Arana as having started a program in English as a Second Language on February 9, 1994, with a scheduled graduation date of February 1, 1995. The Master Sheet further showed Ms. Arana as making satisfactory progress in this program through September 28, 1994. Most disturbing, however, is the fact that the Master Sheet also shows IADE as having received two payments on a Pell Grant for Ms. Arana of $1150 each on February 9, 1994 and June 10, 1994. Department of Education records confirm that a $2300 Pell Grant was paid on behalf of Maria Arana.

In light of Ms. Arana's statement to the Staff that she never attended IADE, the only way in which IADE could have maintained the information which it had for Ms. Arana (and therefore the only way in which it could have obtained a Pell Grant for Ms. Arana) would have been through the wholesale creation of phony attendance and academic records.

Unfortunately, the case of Ms. Arana is not an isolated instance. The Staff discovered numerous other examples of IADE having fabricated student records in order to obtain Pell Grants on behalf of students who never attended. Indeed, the Staff found Master Sheets showing academic progress and Pell Grant disbursements for thirteen students in addition to Ms. Arana who were listed by IADE as no-shows. According to the Department of Education's Student Payment Summary, IADE received over $24,875 in Pell Grants on behalf of these students. The Staff found no record of IADE ever having made any refunds for any of these students, including Ms. Arana.

IADE's fabrication of records to create enrolled students was blatant and intentional. Moreover, this fabrication went beyond the creation of "ghost" students and included the falsification of records pertaining to students who had in fact enrolled but subsequently withdrew or dropped out of school. Maria McFarlane, a former Financial Aid administrator, told the Staff that student educational and financial aid records were altered by Ken Williams, IADE's corporate Financial Aid Director, and his assistant, Melissa Cuesta, at the direction of Sergio Stofenmacher in order to cover up the fact that IADE had failed either to make required Pell Grants at all, to make them in the proper amount, or to make them within the required time frame.

According to Ms. McFarlane, if IADE had received a Pell Grant check on behalf of a student who had withdrawn before completing at least half of his course, the information on the student's Master Sheet would be changed to make it appear that the student *had* completed half the course. Ms. McFarlane told the Staff that Mr. Williams and Ms. Cuesta sometimes came into IADE's offices at 2 or 3 o'clock in the morning to make such changes. Comments she overheard Mr. Williams making further increased her concerns about what he was doing—for example, Ms. McFarlane stated she had overheard Mr. Williams at one time telling Ms. Cuesta to "watch your mouth" when she was apparently saying something in front of others that he did not want to be known.

Ms. McFarlane also told the Staff that Sergio Stofenmacher had instructed a number of other employees to engage in the falsification of records. In particular, Ms. McFarlane stated that she observed Taimi Aleman, a former administrator at IADE's corporate headquarters, alter attendance records and fabricate examinations and other educational records for students who had dropped out. According to Ms. McFarlane, the effect of these actions was to lessen the amount of refunds IADE would otherwise be required to make or in some cases, to allow IADE to evade making any refunds at all. Ms. McFarlane said that she personally observed Ms. Aleman alter hundreds and possibly thousands of students records in this manner at Sergio's direction.

The Staff learned of additional abuses of the student record system from other IADE employees. Shirley Diaz, the former Financial Aid Director at IADE's South Gate campus, told the Staff that when she first started working for IADE, Pell Grant checks were not cashed until the school confirmed that a student was actually attending classes. She stated that subsequently Sergio Stofenmacher directed that students' financial papers should be processed and that Pell Grant checks should

be issued and cashed *before* the students even started classes because IADE was "tight in its budget" and needed the award money.

Ms. Diaz further told the Staff that her original practice (and the required practice under federal rules) was to post no-show students and student drops to the record system as they occurred. She stated that she was subsequently directed not to post no-shows or drops at all because to do so would generate too great a refund liability for which IADE did not have the money. As a result of this directive, Ms. Diaz did not post no-shows and drops for approximately six or 7 months in 1993. Ms. Diaz estimated that this led to a backlog of some 900 students for whom IADE had improperly collected Pell Grants because they had not been properly posted in the records system as no longer being enrolled.

Apparently, this deliberate failure to post drops and no-shows went on for quite some time. On July 14, 1994, Ken Williams addressed a memorandum on this issue to the Stofenmachers and IADE's Corporate Counsel Gonzalo Frixes. Interestingly, this memorandum was marked urgent and confidential and stated that it was not to be shared with anyone other than those to whom it was addressed. In his memorandum Mr. Williams stated,

> there are approximately 1,607 students who are no-shows, withdrawals, terminations, etc. who have not been posted to the RGM system as no longer enrolled. Approximately 75 percent of IADE's students who drop trigger refunds. In turn, the average refund for [sic] due for each student for whom a refund is triggered is approximately $859. As such, these students when posted will create approximately $1,035,310 in additional refunds.

Mr. Williams went on to estimate that as of June 30, 1994, IADE's total liability in refunds due, including both posted and non-posted refunds, was nearly $2.5 million.

Mr. Williams' memorandum is amazing in its candor and provides perhaps the clearest picture of the types of abuses which were occurring at IADE. For example, at the beginning of his memorandum Mr. Williams stated,

> As you are aware, during this same period between 7/1/93 and 6/30/94 in order to increase cash flow we eliminated a number of checks and balances which allowed checks to print which would not normally have printed and/or been deposited into IADE's general fund.
>
> * * *
>
> Relaxing previously existing procedures allowed IADE to significantly increase cash flow in the short run. However, in the long run, the changes dramatically increase the amount of refunds due. For example, many of the students for whom we printed and deposited checks, should never have received any Pell funds at all. Consequently, as soon as the drop information is posted for these students, we will be forced to pay back ALL [emphasis in original] of the money we received for them. As I warned when IADE's senior management first decided to do this, the long term implications for refunds owed has been dramatic.

Later in the memorandum, Mr. Williams recommended that IADE should begin paying and posting refunds. He then went on to state,

> It should be noted that it may be possible to move some of these payments and postings back by as much as two to 4 weeks. However, the greater the delay the greater the risk we run in terms of audits, excess cash, reimbursement and/or having our aid eligibility and/or license to operate terminated. *Perhaps as significantly, because RGM is also required to undergo Federal audits, RGM has threatened that it might be forced to eliminate IADE's ability to post its own refunds. If this were to happen, we would actually have to provide deposit slips to RGM for each refund made and wait until they had the opportunity to post the refund as paid before it would show on the system. This would totally eliminate our ability to post refunds as paid before they really were. The implications for our ability to quickly "fix" things during an audit are obvious.* [emphasis in original]

Perhaps most incredible is the concluding admonition contained in Mr. Williams' memorandum in which he warned of the consequences of not correcting the refund problem. There he stated,

> IADE will be required to undergo what are now annually required student aid audits and will, as we have already been admonished by the Nunn Committee, will be required to provide AUDITED FINANCIAL [emphasis in original] statements. These audits coupled with the audited financial

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statements will, given the auditor's familiarity with the RGM system, reveal the unpaid refunds. Even if we retained an auditor unfamiliar with RGM, the refunds would either be discovered during the file review or would be discovered when the auditor, as required by Federal law, met with RGM. In fact, all an auditor would have to do at this point to discover the unpaid refunds would be to look at our bank statements for the period between 7/1/93 and 6/30/94. The statement would show no refund deposits except for $284,866 for the entire award year. They would show only Federal Funds transfers. Given the prior response of the US Department of Education and ACCET's prior concerns regarding our past refund problems they would almost certainly move to revoke aid eligibility and accreditation if it were discovered that we had failed to pay refunds after convincing them that we had solved our prior problems. Frankly, even once the refunds are paid, they are already late. As such, the longer we wait to pay the refunds the greater the risk to IADE. Our biggest dilemma is that though we could once again relax check printing procedures to generate more income in order to pay the 93–94 refunds, this would only create more refunds next year and make the problem worse assuming we could hide it for another year which, frankly, we can't. Frankly, in light of the Nunn investigation, if they discovered and could prove that IADE had deliberately hidden refunds and provided false information to Congress, IADE's senior management could face criminal prosecution. I say this not to scare you, but to point out as I have before that we have to fix this problem before it is discovered by some outside agency.

Earlier this year, in response to an unannounced visit by ACCET which discovered the problem of no-show students, Abraham Stofenmacher admitted that there was an "unusual set of circumstances during a portion of the 1993–1994 Federal aid award year which *inadvertently* [emphasis in original] resulted in a limited number of students who signed enrollment agreements but never began classes receiving Title IV Funds." According to Mr. Stofenmacher, "a limited number of enrollment status errors by academic clerks within IADE's Office of Education unintentionally bypassed a series of institutional controls designed to prevent this type of problem from occurring. . . ." In light of the document alteration and falsification uncovered by the Staff, and particularly in light of the July 1994 Ken Williams memorandum, the Staff finds Mr. Stofenmacher's reference to a "limited number" of errors "unintentionally" causing ineligible students to receive Pell Grants to be somewhat disingenuous.

3. Where Did The Money Go?

As has been mentioned previously in this statement, IADE American Schools took in approximately $58 million in federal Pell Grant money from 1990 to 1995. Throughout most of these years, this money represented between 90 percent and 100 percent of IADE's yearly revenue. Based on what the Staff discovered during its investigation, it appears that very little of that money was used by IADE to provide books, supplies, equipment, placement services, or any of the other necessities of a quality vocational education. Most of its buildings were leased, as was almost all of its equipment such as computers and photocopiers. Moreover, much of the federal money which IADE did receive was for students who either withdrew or never attended and for whom IADE therefore incurred little or no expenses. In light of this, one would think that IADE should have had no cash flow concerns. A closer examination, however, shows that IADE has been in serious financial difficulties for a number of years.

The Staff obtained a Business Information Report on IADE from Dun & Bradstreet Information Services. These reports are compiled by Dun & Bradstreet based on information supplied to it directly by the company itself, as well as other public sources of information. The Dun & Bradstreet report paints a revealing portrait of IADE's financial condition.

For example, the report's Payment Summary section shows that IADE was late by an average of 78 days in paying its obligations. One creditor had even placed IADE in collection for a past due obligation in the amount of $30,000. In addition, IADE had a number of judgments and liens filed against it. Included among these was a judgment of $27,651 entered in March of this year as a result of a suit filed against IADE by five former students claiming that the school failed to provide the training and job placement which it had promised in its advertising. Among the liens filed against IADE were a lien for over $4,000 filed by the State of Florida for unpaid State taxes, a lien of over $137,000 filed by the State of California for unpaid State taxes, and a lien for over $400,000 filed by the IRS for unpaid federal

taxes. In addition, a mechanics lien of $1,100 had been filed by Oxnard Building Materials Company for items purchased for IADE's South Gate campus.

Representatives of Dun & Bradstreet told the Staff that officials in the Department of Education's student loan section regularly reviews its reports and are provided updates whenever a school participating in the loan program starts paying obligations late, submits new financial statements, or incurs a judgment or lien. According to these representatives, though, the Department's Pell Grant section has no similar arrangement; nor apparently do they receive this information from the loan section.

The Staff also obtained a sense of IADE's financial difficulties from interviews with various IADE employees. Many told the Staff that from time to time their paychecks were not honored by the bank for lack of funds. Deborah DeVries, IADE's former Director of Education, stated that on at least two occasions, one in May 1992 and another in March 1993, her paycheck was not honored. She also complained that in May 1994 she was still waiting for payment from IADE for two in-service training workshops which she had conducted in October 1993.

Luz Zamorena, IADE's former Office Manager and Director of Personnel, told the Staff that IADE's financial problems seemed to start about the time Sergio Stofenmacher came to the school in 1990. According to Ms. Zamorena, the first signs of problems showed up in the accounts payable area. Beginning in 1990, accounts which previously had always been paid on time increasingly became past due. Ms. Zamorena also confirmed to the Staff that on at least three occasions, once in 1992 and twice in 1993, her paycheck, and those of at least fifty other employees, was not honored. Arnoldo Sanchez, IADE's former Curriculum Coordinator, similarly told the Staff of paychecks bouncing in 1993 and 1994.

Where then did the money go? According to Mr. Sanchez, IADE's problems with insufficient funds often seemed to coincide with those times when Abraham Stofenmacher returned to Argentina. While the Staff was unable to confirm his information, Mr. Sanchez stated that it was generally known that when Abraham Stofenmacher travelled to Argentina he normally took a suitcase of money with him. Ms. Zamorena told the Staff that another reason for IADE's poor financial condition was that Sergio Stofenmacher took $100,000 from IADE's Federal Funds Account and put it into a bank certificate of deposit. The existence of a $100,000 certificate of deposit was also confirmed by IADE's Corporate Financial Aid Director, who stated that the certificate was used at one point to pay off some of the refunds IADE owed. The Staff was unable to ascertain whether this certificate was taken out in Sergio's name or in IADE's name; however, a review a IADE's financial statements shows no reference to IADE's holding such a certificate.

Another IADE employee told the Staff of an argument he overheard between Sergio and his father Abraham in the latter part of 1993. The employee stated that he did not understand what was being said because the two were arguing in Spanish; however, some Spanish speaking co-workers who had also overheard the argument explained to him that Abraham had accused Sergio of diverting funds from IADE. Apparently, Sergio owned a number of companies, both related and unrelated to IADE. According to the explanation provided by the co-workers, Abraham had accused Sergio of using IADE funds to pay the employees of these companies. The co-workers also explained that Abraham accused Sergio of using IADE funds to write checks to his girlfriends.

In addition to the statements of IADE's employees, the Staff's review of IADE's general ledgers and check registers also provided some interesting information as to where some of IADE's money was going. The Staff undertook a limited review of checks written by IADE during the 6 month period of August 31, 1993 through January 31, 1994. During this time period IADE's revenue from Pell Grant drawdowns was $8,382,000. As the Staff has noted previously, IADE's total yearly revenue was comprised almost 100 percent of Pell Grant drawdowns. The Staff's review uncovered the following payments for this 6 month period:

Payee	Number of Checks	Total Paid
Abraham Stofenmacher	8	$ 7,097.97
Alejandro Stofenmacher	11	92,951.75
Bernardo Stofenmacher	11	84,591.75
Sergio Stofenmacher	35	161,483.50
Alley Parking	37	112,050.00
Casa Management	40	181,050.00
COTC	19	41,650.00
IADE American Schools	100	1,449,829.77
KMEX TV	12	266,660.00
T&P Advertising	30	262,920.00
Mercedes Benz	22	14,144.72
BMW Credit Corp	11	5,283.70
District Attorney Child Support	13	2,541.50
Total		$2,682,254.66

The Staff notes that Alley Parking, Basa Management, COTC, and T&P Advertising, which received a total of almost $600,000 during this time period, are all companies owned by the Stofenmachers. The payments to T&P Advertising are particularly noteworthy. T&P was an advertising agency created by Sergio, Bernardo and Alejandro Stofenmacher. According to IADE's former General Counsel, by creating its own company IADE could place its advertising at the 15 percent discount rate normally offered to advertising agencies. Given the amount of money IADE committed to advertising, this type of discount could be quite significant.

It appears, however, that although IADE apparently paid T&P for advertising services, T&P did not always pay for IADE's advertising. For example, the Staff compared a breakdown of invoices and payments prepared by KMEX TV against IADE's general ledger and check register. During the 6 month period examined by the Staff, each of the payments received by KMEX TV can be traced to a check written directly from IADE's account, not T&P's account. In fact, IADE's check register shows that it paid $266,660 directly to KMEX TV. At the same time, IADE paid T&P $262,920, ostensibly for the placement of advertising. If IADE paid KMEX directly for its advertising during that time period, then the Staff questions what the payments to T&P were for.

The payments to Mercedes Benz and BMW Credit Corporation represent payments on leases of vehicles which were used personally by the Stofenmachers. A copy of the lease between Nick Alexander Imports and IADE shows IADE leasing a BMW 325IC convertible at a total lease price of $31,080.60. The lease appears to be signed on behalf of IADE by Bernardo Stofenmacher. Most noteworthy is that Mr. Stofenmacher check the box on the lease listing his intended use of the vehicle as "personal, family or household purposes."

Also of note among IADE's payments is the $2,541.50 paid from the school's account for child support payments. From what the Staff has been able to determine, these payments were made to satisfy child support personally owed by Sergio Stofenmacher. Of course, the largest amount of checks during this time period, both in terms of number of checks and total dollar value, is the 100 checks totalling almost $1.5 million made out to IADE. The Staff's review shows that these checks were written on a number of different IADE accounts and were endorsed and cashed by various of the members of the Stofenmacher family, much as one would write out a personal check for cash. The Staff was unable to trace where any of this money went. This pattern of check writing, though, was significant; in one 3 month period in 1992, over 800 checks, totalling $4.5 million were made out to IADE and endorsed by one of the Stofenmachers.

A number of checks were also written out in the names of the individual Stofenmachers. Given that each of the Stofenmachers was a paid officer of IADE, the fact that there are checks made out to them should not in and of itself be unusual. Even assuming that these checks represent salary payments, though, some anomalies still appear. Each of the Stofenmachers received a substantial salary—Abraham received $146,640; Bernardo and Alejandro received $200,000; and Sergio received $220,000. If one assumes that the checks are for salary, then the amount paid to Bernardo and Alejandro over this period of 6 months represents 42 percent and 46 percent respectively of their yearly salary. The payments to Abraham, however, represent only 5 percent of his salary; while the payments to Sergio represent 73 percent of his salary.

In addition to their salaries, at least some of the Stofenmachers also received interest free loans from IADE. IADE's financial statement for the period ending January 31, 1992 lists $144,395 in advances to officers. A note to the financial statement explains that this amount represents non-interest bearing loans to IADE officers; however, the note does not list which officers received the loans. IADE's only officers, though, are the four Stofenmachers. By the time of the following year's financial statement, that is for the period ending January 31, 1993, the figure for officer advances had ballooned to $379,833. Following this statement, though, some interesting changes occur in this figure. Just eleven months later, IADE issued a financial statement covering the period ending December 31, 1993. In this statement the figure for officer advances is suddenly down to $47,377. A review of IADE's general ledger, however, reflects no repayments by any company officer, nor was any other evidence found of such repayment. One month later, IADE again issued a financial statement, this one for the period ending January 31, 1994. In this statement the figure for officer advances, which only the month before had been less than $50,000, was now almost $200,000.

The Staff was unable to ascertain what these loans were used for; however, we would note that each of the Stofenmachers owned residences in the Los Angeles area with mortgages of over half a million dollars. Sergio Stofenmacher, in addition to his Los Angeles residence, also owned a resort home in Lake Arrowhead with a mortgage of $200,000. The Staff also notes that Abraham Stofenmacher, along with his wife Ruth, controlled a partnership during this time called the 121 South Canon Drive Partnership. Among the assets of this partnership was a piece of property located at 301 N. Foothill Road in Beverly Hills. Partnership documents show capital contributions to the partnership of $241,655 in 1993, a significant contribution given the fact that Abraham's annual salary amounted to less than $150,000.

The mysterious rise and fall and rise again of the figure for officer advances is perhaps symptomatic of larger problems with respect to IADE's financial accounting. According to a former IADE employee, serious problems concerning IADE's financial statements came to light during a 1992 reaccreditation visit by ACCET. Specifically, ACCET had questioned a large sum of money that had been written off as a loss by IADE. This write-off supposedly covered bad debts from students who had attended IADE and had not paid what they owed the school.

The members of the accrediting team, however, found that IADE was extremely behind in its accounting. One of the team members, Mike Gould, subsequently told the Staff that IADE's accounting practices were so poor that he didn't think that the school would even have known if it had bad debts. He stated that IADE hadn't posted drops or withdrawals, that the school didn't know which grant went with which student, and that it was behind over $160,000 in its payroll taxes. Mr. Gould told the Staff that it became clear to him after talking to IADE's comptroller at the time that IADE couldn't create an accurate financial statement. Indeed, Mr. Gould was of the opinion that IADE "did not have a clue" as to what their financial status was and that, as a result, it was just making up its financial statements. If this is true, it certainly has serious implications, not only for IADE's ability to provide an accurate picture of its financial condition, but also for its ability to account for the millions upon millions of federal taxpayer dollars which the school received over the years.

Failures of the Regulatory Triad

The participation of institutions in federal student financial assistance programs is subject to a regulatory triad consisting of State licensing authorities, independent accrediting agencies, and the federal Department of Education. Each of these entities is responsible not only for making determinations affecting entry into the programs (a process known as gatekeeping), but also for conducting continuing oversight to ensure that a participating institution remains in compliance with applicable program requirements.

Over the years the Subcommittee has been quite critical of the ability of this regulatory triad to prevent fraudulent institutions from gaining access to the program in the first instance or to subsequently detect and pursue fraud by such institutions once access had been gained. Unfortunately, the case of IADE represents one more example of the failure of this system.

From the time it first entered the federal student financial assistance program in 1989, until the time it closed its doors and filed for bankruptcy in 1995, IADE underwent over a dozen audits, examinations, and reviews by the California Council for Private Postsecondary and Vocational Education, the Accrediting Council for Continuing Education and Training, and the Department of Education. Each of these audits, examinations, or reviews found problems of varying degrees in one as-

pect or another of IADE's operations. At various times IADE was found to owe the federal government money for student financial assistance funds it should not have used; twice IADE was placed on reimbursement for brief periods of time and once there was even some consideration given to terminating IADE from the program. None of the members of the triad, though, ever seemed capable of understanding the full extent of the abuse going on at IADE. As a result, IADE managed to retain its access to federal funding with little or no serious impairment of its activities until earlier this year, when an unannounced site visit by its accrediting agency based on an anonymous tip led to the termination of IADE's accreditation. By that time, however, IADE had taken in almost $58 million in federal student financial assistance funds.

1. Gatekeeping Process Failed to Detect IADE's Manipulations

On September 6, 1989 IADE American Schools was certified by the Department of Education as eligible to participate in the federal guaranteed student loan program and the federal Pell Grant program. The certification and eligibility process represented one of the first chances available to the regulatory triad to examine IADE's operations and to prevent the possibility of a potentially abusive institution gaining access to federal funds. Unfortunately, the gate was opened for IADE at this stage, despite application documents which on their face should have raised questions about IADE's eligibility.

Under the Higher Education Act and regulations promulgated pursuant thereto, a proprietary school must meet certain minimum program length requirements in order to participate in various of the federal government's student assistance programs. As the law stood at the time of IADE's application, short term programs of 300 to 600 clock hours were considered eligible only for participation in the guaranteed student loan programs. Programs of 600 clock hours or more were considered eligible for participation in other federal financial assistance programs such as the Pell Grant program and the College Work Study program. Programs of less than 300 clock hours were considered ineligible for any federal financial assistance program.

On its application for initial certification IADE listed the various courses it offered at each of its campuses. Most of the campuses offered similar programs as illustrated by the following listing for IADE's main campus at South Gate:

Name of Program	Clock Hours
Electrician Residential Installer	100
Electrician Residential, Commercial & Industrial	600
Automobile Electricity and Diagnosis Technician	400
Automobile Electricity, Diagnosis & Brakes Technician	500
Automobile Electricity, Tune-Up & Brakes Technician	700
Gasoline Engine Specialist	180
Tune-Up Specialist	180
Computerized Office Systems Specialist	600
Electronics/Computer Technology	400
Electronics & Assembly Technology	300
Electronics Technology	180
Refrigeration and Air Conditioning Service	160
Microcomputer Systems Operator	310

Of the programs listed, only three met the minimum program length requirements for participation in the Pell Grant program. Five programs met the requirements for participation in guaranteed student loan programs only. Another five, however, did not meet the minimum length requirements for participation in any program.

To its credit, the Department, in its Notice of Institutional Eligibility, did limit IADE's eligibility to those eight educational programs which were over 300 clock hours; however, in both the Notice and the subsequent Program Participation Agreement no distinction was drawn as to which of the approved educational courses were eligible for which type of assistance. According to a senior level Department employee, the Department at that time left it up to the institutions to police themselves in order to make sure that they were applying the appropriate financial assistance funds to their various programs.

A few months after the Department had granted its initial certification, IADE reapplied for certification on the basis of a change in its course measurement methods from clock hours to credit hours. In the process of making this new application,

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IADE dropped five of the previously eight certified programs, including four of the programs which had not been eligible for Pell Grant participation. Of the three programs remaining from the initial certification, two had met the requirements for Pell Grant participation and one had not. IADE's change from clock hour to credit hour resulted in this one program now becoming eligible for Pell Grants as well. IADE's application also added a totally new educational program for a Security Licensed Officer, which under IADE's credit hour conversion method also met the requirements for Pell Grant participation.

Despite this wholesale change in IADE's course offerings only months after receiving its initial certification, the effect of which was to drop educational programs which did not qualify for Pell Grants and to ensure the eligibility of those remaining programs, no flags were raised within the Department of Education. The Department granted IADE certification for its revised programs and the school thus had complete access to Pell Grant funding.

2. Institutional Monitoring Failed to Gauge the Full Extent of IADE's Abuses

While participating in federal student financial assistance programs, IADE was subject to continuing institutional monitoring by its State licensing authority, its independent accrediting agency, and the Department of Education. Any one of these arms of the triad could have taken action against IADE which would have led to the school's no longer being eligible to obtain federal dollars. Unfortunately, none of them seemed capable of taking swift, sure, and effective action to stop the ongoing abuses at IADE.

a. Despite State Findings of Non-Compliance, IADE Escaped Sanctions for Over a Year and a Half

In order to participate in Title IV programs, an institution must be licensed or otherwise legally authorized to provide a course of postsecondary education by the appropriate agency in the State in which it is located. IADE's main campus was licensed by the California Council for Private Postsecondary and Vocational Education (the "CPPVE") on September 12, 1983. Additional campuses were licensed in 1986.

The CPPVE's first substantive audit of IADE's operations took place in May 1993. This audit was initiated to determine IADE's compliance with applicable laws and regulations pertinent to the administration of the school's English as a Second Language ("ESL") programs. In the course of conducting this ESL audit, however, the CPPVE also made significant findings and observations in other areas as well.

The CPPVE audit report was not issued until September 8, 1993, almost 5 months after the audit was conducted. That report listed nine areas in which the CPPVE found IADE had failed to comply with California and/or federal laws and regulations. Among the major findings were:

—ten ESL instructors lacked required Certificates of Authorization and five financial aid staff members had failed to attend required financial aid training;
—the certification required prior to Pell Grant disbursement to document students' prior knowledge, skills, and training was not adequate; and
—certain pre-enrollment appraisal examinations were not graded correctly, resulting in over-charges of Pell Grant funds.

Along with each finding of non-compliance the audit report listed the action required to bring the school into compliance.

IADE response to the audit report came a month later in a letter to the CPPVE dated October 15, 1993. For the most part, IADE accepted the CPPVE's findings and agreed to undertake the required corrective actions. The one major area with which IADE disagreed was the CPPVE's finding regarding the documentation of ESL students' prior knowledge, skills and training. IADE claimed that the State's standard for documentation in this area was more stringent than the federal standard and that imposition of such a standard was premature in light of an ongoing task force which was examining the issue. IADE therefore did not comply with the CPPVE's audit requirement that it perform a portfolio review of students enrolled after January 1, 1993 to determine whether adequate documentation existed of prior knowledge, skills, and training.

It took another month for the CPPVE to respond to IADE's response. In a letter to IADE dated November 11, 1993, the CPPVE found IADE's response to this issue unacceptable. The school was again instructed to perform the review and was provided with a list of criteria specifying the exact documentation the CPPVE would

find acceptable. If such documentation could not be located in a student's file, the school was to contact the student and collect the required information. IADE was told that failure to comply would require that the school make a full refund of tuition and fees for any student for whom documentation was lacking. IADE was then given another thirty days to respond.

IADE continued to hold to its position that it should not have to comply with State standards which were more stringent than federal standards, and did not perform this review. Despite IADE's refusal to comply with its directives, and despite the fact that a failure to comply with audit findings could form the basis for denial of licensure, the CPPVE nevertheless granted conditional approval to IADE's ESL program until June 1994.

The primary condition attached to IADE's approval was that the CPPVE would conduct a follow-up audit prior to the expiration of the approval. This audit was conducted on May 31, 1994, and an audit report was issued on August 29, 1994. That audit report once again found that IADE had failed to adequately document prior knowledge, skills and training. The CPPVE required IADE to refund all tuition and fees for those students for whom adequate document did not exist and further directed the school to engage the services of an independent certified public accountant to attest to the school's compliance with the requirement and the occurrence of the refund payments.

In addition to the documentation of skills issue, the 1994 audit contained a number of other significant findings, including:

—a failure to provide financial documents to the audit team, or to provide them in a timely fashion;
—a failure to satisfy financial responsibility requirements;
—a failure to pay refunds in a timely manner;
—a failure to provide requested information pertaining to refunds;
—the disbursement of Pell Grant funds prior to the processing date of students' Electronic Student Aid Reports; and
—the disbursement of Pell Grant funds without confirmation of citizenship status

On October 3, 1994, IADE requested—and was granted—a sixty day extension to respond to the findings of this new audit. The school finally did respond on November 23, 1994, nearly 3 months after the date of the audit report. Once again, the CPPVE found IADE's response to be inadequate, particularly with respect to the issues of inadequate documentation of prior skills, the failure to pay refunds in a timely manner, the failure to provide documentation requested during the audit, and the failure to satisfy financial responsibility requirements. On the issue of documentation of prior skills, IADE failed to follow the CPPVE's directive to engage a certified public accountant and failed to provide evidence of refund payments. Apparently, the CPPVE had finally decided that it had had enough—it informed IADE that it intended to pursue administrative action against the school.

By this time, however, it was already January 1995, over a year and a half since the CPPVE's first audit of IADE had discovered some of these problems. During that year and a half period IADE drew down over $10 million in Pell Grant funds. Even the CPPVE's decision to pursue administrative action did not bring swift results. Apparently, while the CPPVE has independent authority to license schools, it does not have independent authority to revoke licenses already granted. In order to do so, the CPPVE is required to refer the matter to the California Attorney General's office. The Attorney General's office would then make a determination whether to pursue an administrative action seeking revocation. On January 9, 1995, the CPPVE sent a memorandum to the Attorney General's office referring the IADE audit issues for administrative action. By the time IADE closed its doors on March 13, 1995, the Attorney General's office had not yet taken any action on that referral.

b. Accrediting Agency Found Indicators of Abuses, But IADE's Deceptions Allowed It to Maintain Its Accreditation

In addition to being licensed by the State in which it is located, an institution must also be accredited by an independent accrediting agency approved by the Secretary of Education. IADE was accredited by the Accrediting Council for Continuing Education and Training ("ACCET") on July 1, 1989 for a period of 3 years.

In July 1992, ACCET conducted a review of IADE's operations in connection with its consideration of IADE's reaccreditation. That review found a number of areas of weakness, including the following:

—IADE's business plan was considered "elementary and not well thought out";

—Numerous grade and attendance records had been "whited out" and changed;
—There was an indication of inconsistent charges being levied for tuition and fees;
—Student records were found to be inadequate; and
—Placement services were found to be inadequate.

As noted previously in this statement, the problems with IADE's placement services were of particular concern to the accreditors. The accreditation report noted that this was one area where IADE was not following the accrediting agency's policies. As a result, ACCET decided to defer a decision on IADE's reaccreditation, pending the receipt of additional information from IADE and follow-up visits to all IADE campuses, until the agency's next regularly scheduled meeting in April 1993.

Prior to the receipt of that information, ACCET received correspondence from the CPPVE dated August 24, 1992, informing it of a State investigation of certain complaints filed against IADE. ACCET also subsequently received a copy of a September 9, 1992 letter to IADE informing it of the results of the State's investigation. On the basis of these complaints, ACCET scheduled an unannounced site visit to IADE. This visit took place in October 1992.

Although the ACCET team did not find substantiation for many of the complaints filed with the State, it did take note of a number of other problem areas, including placement, student records and financial aid. With respect to financial aid, the team found the following:

> The tuition appears to be set at a level that given the length of the programs,[sic] it can be covered exclusively with Pell grants. Students interviewed commented several times that they are going to school free. Several students expressed frustration and confusion over how they are paying for school. They stated that they were told to "sign here, put this amount here, etc." and then the first week of classes they were told what they would be awarded. They do not understand that they are using two or three Pell grants, both partial and full, to pay for their education.

In a December 1992 meeting ACCET reviewed the report of this site visit along with IADE's response to the report and its response to the report of ACCET's previous reaccreditation site visit. Based on this review, ACCET found that there were still a number of issues which needed clarification regarding IADE's compliance with ACCET's standards, policies, and procedures. Among these, as noted in a January 13, 1993 letter to IADE, were:

—The institution did not demonstrate financial stability as evidenced by its reviewed financial statements for the period ending January 31, 1992, which reflect a current ratio of less than 1:1 and unpaid refunds. The institution did not provide a financial recovery plan to explain how the institution will ensure financial stability as requested in the Commission's August 21, 1992 letter. Although the institution provided an explanation of the $557,000 of tuition refunds due, it did not provide any evidence to demonstrate that the refunds have actually been paid;
—The Commission noted that the institution underwent a compliance audit by the Inspector General's (IG) office and that the institution had not yet received a copy of the audit but was willing to supply a copy to ACCET as soon as it becomes available. Until the results of this audit are available, full compliance with this standard cannot be determined;
—Although the institution stated that the record cards showing grades and attendance are in order at the Oxnard branch, it did not provide any evidence to support that statement; therefore, the institution did not demonstrate that attendance records at the Oxnard branch are reliably and regularly kept;
—While the institution's December 1992 interim report indicated that "white out" no longer is being used on permanent records and that its records are accurately maintained, evidence to support these statements was not provided; and
—The completion and placement data submitted by the institution was not presented in a manner which allowed for verification of the statistics provided for the completion and training-related job placements. The institution appears to be reporting all graduates who are working (regardless of whether they are working in a related field) as placements.

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In light of these issues, ACCET determined to continue the deferral of IADE's accreditation until the next ACCET meeting in April 1993. At the same time, however, ACCET directed IADE to show cause as to why its accreditation should not be withdrawn.

Had IADE's accreditation been withdrawn, it would no longer have met the requirements to be an eligible institution for purposes of participation in Title IV programs. Once again, however, IADE managed to dodge a potentially fatal bullet. IADE's response to the show-cause directive apparently was convincing enough to lead ACCET to believe that the school was instituting the changes necessary to bring it into compliance with ACCET standards. In addition, an ACCET follow-up visit in March 1993 found much improvement in a number of previous problem areas. In describing these improvements, the follow-up report used such terms as "dramatic turnaround," "significant effort," and "noticeable changes." The report concluded with the following statement:

> The team was able to verify and observe many noticeable, positive changes made at each of the IADE campuses. Management concurred with the team that the changes made as a result of efforts of the visitation teams, the Accrediting Commission, the school's staff, and the corporate staff has [sic] had a very positive result on the entire operation.

On the basis of IADE's response and the follow-up report, ACCET determined at its April 1993 meeting to vacate the show cause directive and grant IADE reaccreditation; however, due to the outstanding issue of the Inspector General audit and other areas of minor concern, the reaccreditation granted was for a 3 year period rather than the maximum 5 year period. This determination was communicated to IADE in a letter from ACCET dated May 12, 1993.

Of course, what ACCET did not know in vacating its show-cause directive was that much of what its site visit team had observed at IADE was a sham designed specifically for the purpose of deceiving ACCET into believing that IADE was in compliance with the accrediting agency's standards. The Staff has previously cited many of the ways in which IADE carried out this sham, including directing staff members to pose as employers in order to boost placement statistics, listing the names of bankrupt companies on students' placement records, briefing instructors on what to say to the accrediting team members, and preparing new curricula and bringing in new equipment and supplies for purposes of the site visit. Nevertheless, IADE managed to retain its accreditation, and with it a continued access to federal student financial assistance funds.

Over the following year and a half IADE was required to submit quarterly financial reports to ACCET. In addition, ACCET conducted a special review and required additional information from IADE in response to the CPPVE's 1993 report on IADE's ESL program. IADE's responses to these requests were all deemed acceptable by ACCET and no further action was taken.

On January 26, 1995, ACCET received an anonymous letter alleging "discrepancies in the operating procedures" of IADE. The letter hinted at issues of no-show students, inadequate documentation of prior skills, financial instability, and failure to pay refunds on time. ACCET officials viewed this letter as an "urgent complaint" and scheduled an unannounced site visit to IADE. This visit took place on February 3, 1995.

The visit uncovered a number of serious problems, including the following which were detailed in an evaluation team report:

> —Management did not demonstrate that internal and external governance is effective. This is evidenced by lack of key and pertinent student files on site, the inability of the corporate structure to provide documentation of these files that they State were located at the corporate office, and the institution's failure to respond to CPPVE's request for key information, even after a 60-day extension;
>
> —Management did not demonstrate that the role of management is clearly defined, effective, and efficient. This was evidenced by severe weaknesses in the administration of financial aid at the corporate office and by slow and sometimes no response in providing key files to the visiting team under the direction of the corporate office. . . .The campus does not have accurate and accessible information on site to prove that financial aid records are accurately and appropriately administered, that refunds are made in a timely manner, and that payroll taxes, lease payments and rent are up to date;
>
> —The institution did not demonstrate a record of responsible financial management with income sufficient to maintain the educational program.

. . . This was further evidenced by Corporate Counsel's own statements that IADE was experiencing a cash flow problem that made it impossible to provide a paycheck to their contracted testing personnel which amount [sic] to $750.00 even though IADE is a "$16,000,000 annual income organization". . . .;

—The institution did not demonstrate that financial aid programs are capably administered, accurately recorded and documented, and appropriately implemented. The institution did not demonstrate that State and federal requirements are met in the recruiting, awarding, and documentation of financial aid programs. This was demonstrated by a review of 26 students records which did not provide evidence of refund calculations and payments, that satisfactory student progress was appropriately evaluated, and in three cases, that students who received Pell were even enrolled or attended classes; and

—The institution did not demonstrate that tuition refunded and received were clearly documented, and that cancellation and refund policies comply with federal and State regulations. The institution did not demonstrate that refunds are made within thirty days of determination of the last date of attendance. This was demonstrated to the team by incomplete financial aid files, missing files of students who received Pells as verified by RGM reports, lack of documentation in student files that verifies that refund calculations were made, and lack of documentation, such as original cancelled checks, that could verify that refunds were paid.

On the basis of these findings, ACCET issued IADE a directive on March 2, 1995 to show cause why its accreditation should not be withdrawn.

On the same date IADE transmitted a letter to ACCET over the signature of Abraham Stofenmacher. This letter represented IADE's "interim response" to some of the issues raised during the ACCET team's site visit. It is interesting to note that even at this late date IADE persisted in its attempts to deceive its regulators. The letter attempted to explain away the problem of no-show students by referring to "an unusual set of circumstances . . . which *inadvertently* [emphasis in original] resulted in a limited number of students who signed enrollment agreements but never began classes receiving Title IV funds." The letter also referred to an independent audit which IADE had commissioned to determine how much the school owed in refunds. The letter stated that "based on preliminary indications from the auditor we expect the liability to be approximately $130,000." Ken Williams, IADE's Director of Financial Aid, subsequently told the Staff that the letter had been written to imply that this figure represented IADE's total school-wide refund liability, when in fact this was the refund liability of just one of IADE's seven campuses.

By this point, however, IADE had just about run out of time. Within a week of its letter to ACCET, IADE had shut its doors. A few days later, it had filed for bankruptcy. In response to these actions, ACCET, in a letter dated March 16, 1995, withdrew IADE's accreditation. The withdrawal of IADE's accreditation came 2 years and 2 months after ACCET had issued its first show-cause directive to IADE—in the intervening time period IADE managed to obtain $34,295,129 in Pell Grant funds.

c. The Department Should Have Seen Early Warning Signs in IADE's Biennial Audit

Under the Higher Education Act prior to the 1992 amendments, all institutions participating in Title IV programs were required to undergo a biennial financial and compliance audit to be conducted by an independent auditor. The results of this audit were then to be submitted to the Department for review and final audit determination. In September 1992, IADE submitted to the Department's Office of Inspector General the report of an audit conducted by Barry Glasser, C.P.A., covering the period from July 1, 1989 to June 30, 1991. The report also contained IADE's written response to Mr. Glasser's audit findings. The practice in the Department was to have the Inspector General staff review and approve or disapprove these audits and then to send them on to the Department's Audit Resolution Branch for final audit determination actions.

Of the various findings in Mr. Glasser's report, two in particular stand out. The first found problems with IADE's administration of Ability to Benefit testing. Based upon his testing of student files, Mr. Glasser found that approximately 20 percent of students admitted to IADE had not attained the recommended minimum passing score on the test. Mr. Glasser's second major finding was that IADE owed over $540,000 in refunds as of March 30, 1992. According to his report, the exact cause for the refunds due was not determined.

Perhaps the most telling statements occur in Mr. Glasser's report on internal controls. In that report Mr. Glasser States,

> My study and evaluation was more limited than would be necessary to express an opinion on the internal control systems used in administering the student financial assistance programs of the Institution. Accordingly, I do not express an opinion on the internal control system used in administering the student financial assistance programs of the Institution.
> However, my study and evaluation and my audit disclosed the following conditions [i.e., ATB irregularities and refunds owed] and [sic] I believe result in more than a relatively low risk that errors or irregularities in amounts that would be material to the student financial assistance program may occur and not be detected within a timely period.

As we know now, Mr. Glasser's report turned out to be all too prophetic.

Unfortunately, little was done within the Department in response to Mr. Glasser's audit report. The Department's final audit determination letter was sent to IADE on August 25, 1994, almost 2 years after the date the Department first received Mr. Glasser's report. The Staff discussed the timeliness of the Department's action with a former chief of the Audit Resolution Branch. According to this individual, in early 1994 there was a backlog of audits awaiting final determination dating back as far as 1977. It should be noted that a final determination letter must be issued before the Department can take any action against an institution based on audit findings.

After taking almost 2 years to issue its determination letter, the determinations reached by the Department were less than impressive. With respect to the auditor's finding on Ability to Benefit students, the Department noted that the Regional Inspector General for Audit had subsequently also issued an audit report discussing this issue. As a result, the Department decided to postpone final resolution of Mr. Glasser's finding on this issue until it issued a final determination letter on the Inspector General's finding on the same issue. That final determination letter was only issued a little over a month ago.

With respect to the auditor's finding on refunds owed by IADE, the Department ultimately decided not to sustain this finding. It did so on the basis of IADE's response to the finding which claimed that it had satisfied all unpaid refund liabilities and a subsequent letter from the auditor which stated that he was satisfied with the school's response. Had the Department looked closely at IADE's response, though, it might have realized that something was amiss. In support of its claim that it had satisfied all refund liabilities, IADE submitted a computer generated document entitled "Refunds Due Report." This report purported to cover the award years 1988 through 1993 for all campuses. The report lists each category of Title IV programs and then lists columns for "Due," "Paid," and "Balance." The report contained zeros in every column for every category. At the bottom of the report was an entry for "Total of Students with Refunds." This entry also showed all zeros.

While it is true that IADE's response shows zero refunds due, it seems strange, given the fact that IADE admitted it had identified students for whom refunds appeared to be due and had paid all remaining refunds, that the column for refunds paid would also be zero. This is especially so because the report covers all award years going back to IADE's entry into the program. This seemed to have raised no red flags for the Department, however, as it accepted IADE's response in rendering its final determination. As is now known, of course, IADE in fact owed millions of dollars in refunds and, according to an internal memorandum, it would post its own refunds without ever making the necessary deposits. In the words of that memorandum, this enabled the school to "quickly 'fix' things during an audit."

This was not the only discrepancy with respect to the refund issue which the Department should have caught. In Mr. Glasser's report he provides a table showing the sample sizes of students in various categories selected for testing in accordance with the Department's Audit Guide. Under the category for refund calculation, Mr. Glasser states that the IADE was unable to provide him with the population. Nevertheless, his report shows a sample size of 24 students. According to the former Chief of the Audit Resolution Branch, someone within the Department should have asked how an auditor can obtain a sample from an unknown population. Perhaps more importantly, someone should have questioned why the school was unable to provide the population in the first instance.

By the time the Department issued its final audit determination letter on the 1992 audit submission in August 1994, IADE's next audit was already due. This audit had come due in March 1994. IADE, however, never submitted that audit report. Indeed, to this day that report has never been submitted. Despite the fact that IADE continued to operate for another year after failing to submit this report, the

Staff notes that no action was ever taken against the school for this compliance failure.

d. The Department Ignored Indicators of Fraud and Abuse and Mishandled the Opportunity to Shut IADE Down in 1992

Perhaps most disturbing of the various missed opportunities in this case is the fact that the Department of Education, despite having three separate teams examining IADE in 1992, either failed to comprehend or ignored indicators of the ongoing abuses at IADE. Had the Department taken aggressive action in response to these indicators, it might have saved tens of millions of taxpayer dollars. Instead, a review of the Department's actions reveals a tentativeness which ultimately led to the Department's letting IADE continue its activities with virtual impunity.

The Department's first review of IADE commenced in March 1992. This review consisted of an audit conducted by a team from the Inspector General's Office of Audit and lasted from March 2, 1992 until November 9, 1992. The objectives of this audit were to determine: "1) whether [IADE] American Schools' programs were eligible for SFA funds and 2) whether it had operated the SFA programs in accordance with Federal laws and regulations." According to the Assistant Inspector General for Audit, IADE had been selected for this audit because of its recent large increases in Pell Grant drawdowns.

Early on in the audit, the audit team began to receive allegations of potential fraud and abuse related to IADE's participation in Title IV programs from former students, employees and others. Joe Tong, one of the primary auditors conducting this audit for the Inspector General, interviewed Jorge Meza, the former Director of IADE's Los Angeles campus. Mr. Meza stated in this interview that he had participated in falsifying student grades at the direction of Sergio Stofenmacher so that IADE could show the satisfactory progress of its students necessary to ensure the continued flow of Title IV funds. In addition Mr. Meza stated that IADE had altered Ability to Benefit test responses to make students eligible for financial assistance and had falsified its student placement statistics to meet federal requirements. Finally, Mr. Meza informed Mr. Tong that IADE had been "fixing" student records since being notified of the impending audit in February.

Mr. Tong also interviewed Jean Herzog, a senior auditor with Barry Glasser, the certified public accountant who at the time was performing an independent biennial audit of IADE. Ms. Herzog stated in her interview that she had received a complaint that IADE was not making refunds. She said that she had received a Refund Due report which showed that IADE owed over $500,000 for some 700 students. Ms. Herzog also expressed concerned about the slow pace with which IADE was responding to her requests for files pertaining to refunds. Mr. Tong mentioned to Ms. Herzog that IADE was slow in producing files for the Inspector General audit as well. He later speculated in his interview write-up that perhaps IADE was screening the files prior to providing them.

In addition to his interviews, Mr. Tong's review of IADE files and documentation uncovered what appeared to him to be indicators of possible fraud and abuse. Mr. Tong found tests in students' files in which it was clear that the students' signature had been forged. In one example Mr. Tong found a test in the records of a student named Martha in which the first name was misspelled. He also found tests with no answers which were nevertheless given grades of "A," and answer sheets with different answers for the same question, neither of which was marked wrong.

Mr. Tong documented all of these problems in his audit workpapers and sent a report of his findings to his supervisor, James Okura. Mr. Okura apparently decided that these were not issues of concern for the purposes of the audit despite the fact that one of the stated objectives of the audit was to determine whether IADE was operating student financial assistance programs in accordance with federal laws and regulations. Indeed, as late as April of this year, in a meeting with Mr. Okura and others to review his workpapers in light of this Subcommittee's investigation, Mr. Tong was told that the falsification of satisfactory academic progress and the other irregularities he had uncovered were not important because IADE "would have gotten the Pell Funds anyway."

Despite his supervisor's failure to see the significance of his discoveries, Mr. Tong contacted the office of the Regional Inspector General for Investigations. According to staff from the Inspector General's Office of Investigations, it was a letter from Mr. Tong that led them to initiate an investigation of IADE. This investigation, which began with a re-interview of Mr. Meza in March 1992, overlapped the time period during which the Inspector General's audit was ongoing. Meanwhile, the audit was focusing in on just two issues—IADE's grading of Ability to Benefit tests to qualify students and IADE's maintenance of Pell Grant cash balances in excess of federal regulations.

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The Inspector General investigation consisted of nine interviews with former employees and students of IADE conducted from March through August 1992. During those interviews the investigators were told of low grades that were whited out and replaced with passing grades; answers that were given to students taking Ability to Benefit tests; documents that were created indicating students passing tests for course they had never taken; tests that were falsified; course assignments that were manipulated in order to maximize Pell Grant awards; text books in English that were given to students for courses taught in Spanish; and placement statistics that were falsified. One former instructor even told the investigators that he had heard that IADE's owners intended to make as much money as they could in one or 2 years and then sell the school.

These allegations apparently were taken seriously. According to an internal Department of Education chronology prepared by Daniel Dietz, Acting Chief of the Institutional Review Branch, on September 23, 1992, the Office of Inspector General indicated to the Department's Region IX office that it intended to ask the Department's Compliance and Enforcement Division to initiate termination action against IADE. Another internal chronology, prepared by Benito Botello, Acting Regional Director for Region IX, lists an entry for the same date in which it indicates that "prosecution action" would be sought. Whether this reference to prosecution referred to the termination proceeding or to a possible criminal prosecution is not clear.

In response to the stated intention of the Inspector General, the Region IX office asked the Compliance and Enforcement Division to place IADE on reimbursement. Again there is some confusion between the two chronologies, with the Dietz chronology indicating that the request took place on September 23, 1992 and the Botello chronology indicating that the request took place on September 28, 1992.

The Botello chronology states that the reason given for placing IADE on reimbursement was the receipt of student complaints by the CPPVE. These complaints dealt mainly with quality of education and problems with IADE's facilities and Mr. Botello admitted that "the region had to stretch this to cover the possibility of financial aid complaints."

Apparently, however, there was some concern within the Department about using this pretext to place IADE on reimbursement. The entry for September 28, 1992 in the Botello chronology states:

> It had been decided between Region IX and the Branch Chief for Region X, Rockefeller, that to place the school on reimbursement without investigating the problem would appear unfair, so a program review was planned to obtain first hand documentation. Rockefeller, Frank Dvorak, reviewer from Region X and David Hinojosa, reviewer from Region IX were in agreement that the reason for the reimbursement was weak and OIG-Audit had not shared any of the information of their findings with anyone from our offices.

Why the allegations received by the Inspector General investigators were not deemed sufficient in and of themselves to justify placing IADE on reimbursement is not clear. For some reason the Department decided they needed to come up with some after-the-fact support for their action.

The program review lasted a total of 5 days. During those 5 days the reviewers examined just twenty-two files for the award years 1990–1991 and 1991–1992. The reviewers did not focus on the allegations which had been received by the Inspector General investigators; rather they appeared to concentrate on the same issues the Inspector General auditors had concentrated on—improper determinations under Ability to Benefit testing and maintenance of excess Pell Grant cash balances. There view concluded that in fact such improper determinations had been made and that in fact IADE had maintained excess cash balances. In addition, the review found that IADE had a problem with late refunds.

According to the Botello chronology, though, these findings were considered "minor." The chronology then includes some troubled musing, stating:

> Why more serious [findings] weren't found could probably be best answered by the lead reviewer. This question was asked of Mr. Hinojosa upon his return, and his response was that he was following the lead and directions of Mr. Dvorak.

Even though the reviewers did not consider their findings particularly serious, IADE was still kept on reimbursement because of the Inspector General's supposed intention to pursue termination or other serious action against the school.

The Department soon felt itself hard pressed to maintain this position. The Botello chronology contains the following entry for the period October-December 1992:

> During this time period the IRBC [Institutional Review Branch Chief] for Region IX, Botello, spoke with OKURA several times regarding the issuance of the audit report. Botello advised Okura that the program review findings were not serious enough to keep them on reimbursement while waiting for the IG report. IRB was advised first that the report would be issued the first week of November. Later it was changed to the middle of November and then changed to the beginning of December. In the meantime, Ken Williams, the Financial Aid Director of IADE was calling almost daily making an argument that the complaint with the students had been addressed and the issues on the program review had also been addressed and that there was no reason to keep the school on reimbursement. Still we kept the school on reimbursement from September to December.

At the end of November the Region issued its program review report with its findings on the Ability to Benefit testing issue, the excess cash issue and the refund issue. A week later IADE submitted its response to the program review. A few days after IADE's response was received, the Inspector General apparently decided not to pursue an action against IADE. According to the Dietz chronology, on December 8, 1992 the Inspector General decided not to press for termination. As a result, the Compliance and Enforcement Division removed IADE from reimbursement. The Botello chronology places the date of this action on December 10, 1992, stating in its entry that:

> Okura advised that they would not be pursuing prosecution action at that time. Region IX was left with a reimbursement case with no strong supporting evidence. All during this time, OIGA had not released any information on their findings.

In fact, the Inspector General did not release the report of its audit until September 1993, a year and a half after the audit was first begun and a year after it had first asked the Department to place IADE on reimbursement because of its intention to seek the a school's termination. When the audit report finally was issued, its findings practically mirrored those of the program review issued ten months previously.

The Inspector General did no better with the report of its investigation. Despite the fact that the last substantive interview was completed in August 1992, the Inspector General did not issue a report on its investigation until July 1993, almost a full year later. The entire investigation report consists of one and a half pages. What is said in those one and a half pages, though is rather perplexing. The report, written by Special Agent Robert Gonzalez, states:

> An investigation was initiated in April 1992 based upon an interview of Jorge Meja [sic], former IADE school director. The interview was conducted by an OIG auditor, Joe Tong and Eulalie Young of the State licensing authority. Meja [sic] stated that IADE, 1)violated its academic progress policy by not reflecting failing grades; 2) helps students pass ATB tests; and 3) is not accurately reporting its job placement rates.
>
> IS interviewed Jorge Meja [sic], two other former IADE instructors, Ignacio Rosas, Sergio Castro, and former employee Edgardo Rivas. In addition, various students were also interviewed. The interviews revealed a pattern of abusive tactics in recruiting and ATB testing designed to obtain maximum enrollments.
>
> The interviewees reported a pattern of academic progress abuse by allowing "employability factors" such as appearance and attitude be taken into account when grading students. This very subjective technique was recognized by ACCET and did not affect the schools' accreditation. Also, the interviewees confirmed that IADE management pushed staff to enroll as many students as possible and to report student progress electronically so IADE could earn SFA payments as quickly as possible.
>
> However, no person interviewed, including the original complainant, made a credible allegation of criminal wrongdoing. Further, a credibility gap in the objectivity of the former school employees was evident to the interviewers due to the circumstances of their separation from IADE.

The Staff finds it troubling that Mr. Gonzalez chose to characterize the abuse of academic progress standards as consisting of "allowing 'employability factors' such as appearance and attitude to be taken into account when grading students." Of the nine interviews conducted by the Inspector General investigators, only one individual mentioned anything close to this. According to the investigators' interview reports, Sergio Castro, a former instructor, said that "a portion of the grade that was named 'shop and employability' was very subjective." Mr. Castro stated that "it was

determined by the student's knowledge and also by their appearance." Nowhere in the report of Mr. Castro's interview is there any mention of his stating that this procedure had been approved by ACCET, nor is there any evidence of ACCET representatives having been interviewed.

Of additional concern is that Mr. Gonzalez left out of his report the allegations made by Mr. Castro, and each of the other instructors interviewed, concerning the falsification of grades, tests, and student records. Mr. Gonzalez also seemed to emphasize that the abuses revealed were designed to maximize enrollment, while ignoring the clear statements of the interviewees that this activity was designed to maximize Pell Grant funding.

Perhaps most disturbing, though, is Mr. Gonzalez' statement that "no person interviewed, including the original complainant, made a credible allegation of criminal wrongdoing." It is not clear to the Staff why allegations of falsification of student records designed to allow a school to collect federal financial assistance for an otherwise ineligible student does not rise to the level of criminal wrongdoing. Nor is it clear to the Staff why the Inspector General investigators did not pursue the leads offered to them in their initial interviews to determine whether these allegations were credible. Mr. Meza, Mr. Castro, and Mr. Rivas all provided the investigators names of other IADE employees who either knew of or were involved in potentially fraudulent activities. There is no record that the investigators ever interviewed these people. Nor did the investigators ever interview Ken Williams, IADE's Corporate Director of Financial Aid, or any of the Stofenmachers.

The Gonzalez report concludes with the following paragraph:

> Discussions with Jim Okura, OIG Audit Supervisor in charge of the IADE audit, lead to the conclusion that this case be administratively closed. The audit concentrated on: 1) abuse in converting clock hours to semester credit hours, 2) abuse in administering the ATB tests by using a lower cut off score and, 3) IADE maintained cash in excess of a 3 day supply. Okura agreed that the evidence would not support a successful criminal prosecution since most complaints consisted of quality of education, lack of educational material and inadequate equipment issues. The other initial allegations lacked materiality or were not viable since many students did attend and complete the course.

The Staff does not understand why the Inspector General's Office of Investigation would confer with someone from the Office of Audit as to a decision on whether to close an investigation. Nor does the Staff understand why the findings of the audit are relevant to such a decision. Moreover, the statement that the evidence would not support a criminal prosecution because it consisted mainly of quality of education issues ignores the most damning allegations received by the investigators. The Staff finds the investigators' reliance on Mr. Okura's concurrence particularly interesting, especially in light of statements made by Mr. Okura as recently as 3 months ago (well after the U.S. Attorney in Los Angeles had opened a criminal investigation and the FBI had raided IADE's offices) that the academic progress problems and other irregularities first uncovered by Joe Tong were not important because "IADE would have gotten the Pell Grant funds anyway."

The opinion of Mr. Okura and the tone of the Gonzalez report seem in conflict with the initial intention of the Inspector General's office in September 1992, to seek the termination and/or prosecution of IADE. It is apparent from the Department chronologies that by December 1992 the Inspector General's office had changed its mind. The Gonzalez report obviously reflects that changed mindset. What exactly led to this change, however, is not clear, particularly since the Inspector General's investigation had uncovered what would seem to be clear indicators of program fraud and abuse.

Once the Inspector General's reports had been issued, there was very little additional activity within the Department concerning IADE. The Department was required to issue a final audit determination letter on the Inspector General's audit report; however, by mid–1994 the letter had still not issued. As a result, IADE had managed to escape reimbursement, escape termination or prosecution, and return to business as usual. Things suddenly seemed to change, though, once this Subcommittee began its investigation.

The Subcommittee's investigation of IADE began in early April 1994. On approximately April 12, 1994, the Staff spoke with regional Department officials about IADE and its sharp increase in Pell Grant funding. At that time the Staff requested and was furnished with copies of the Inspector General's Final Audit Report, the Department's Program Review Report, and the CPPVE's Compliance Audit. During the week of May 8–13, 1994, the Staff conducted a field investigation in Los Angeles, reviewing documents and interviewing Inspector General representatives, Cali-

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fornia State officials, and current and former officers, employees and student of IADE. During that same time period, the Staff served IADE with a subpoena requesting various categories of documents pertaining to the school's participation in the Pell Grant program. As knowledge of the Staff's visit spread, the Staff began receiving unsolicited contacts from individuals offering to provide information about IADE.

On May 17, 1994, only 4 days after the Staff had concluded its trip to Los Angeles, the Department's Region X office recommended that IADE once again be placed on reimbursement. According to the Botello chronology, the reason for this recommendation was the Inspector General's audit and the Department's program review findings.

The Staff finds it odd that the program review and the Inspector General's audit should have formed the basis for placing IADE on reimbursement at this point. The findings of this same program review, which was by that time over a year and a half old, were considered too minor by the Department to support placing IADE on reimbursement back in 1992; moreover, the findings of the Inspector General's audit, which had been issued ten months previously, mirrored the findings of the program review.

Equally odd is another internal Department document which states:

> . . . it appears that the school's being placed on reimbursement in mid-May may have been based, not on a program review or an OIG audit, but on an independent SFA audit. However, the file shows conflicting reasons why IADE has been placed on reimbursement . . . because of a program review, because of an OIG audit, because of an independent SFA audit.

Perhaps most revealing of the Department's sudden renewed interest in IADE was a phone conversation the Staff had with Frank Dvorak of the Department's Region IX office on May 23, 1994. Mr. Dvorak told the Staff at that time that the Department had put IADE back on reimbursement because of concerns over the unresolved findings of the Inspector General audit. Mr. Dvorak then freely admitted that the decision was made at that time because of the involvement of this Subcommittee in investigating IADE. He stated that the Department was waiting to see what type of response they would receive from IADE and that he did not think the school would be on reimbursement very long. He further stated that if IADE were taken off reimbursement, they could be placed back on in the future based on the results of the Subcommittee's investigation.

On June 29, 1994, IADE was once again taken off reimbursement. This time, however, it appears that the action was taken against the wishes of the Department's program offices. From internal Department documents and interviews with Department employees it appears that the Department's Office of General Counsel unilaterally agreed to a settlement with IADE under which the IADE would be taken off reimbursement in exchange for its establishing a $500,000 letter of credit in the Department's favor. The General Counsel agreed to this settlement despite the fact that the audit report on which the reimbursement action had allegedly been based had found IADE liable for over $1.3 million in improperly disbursed Title IV funds.

The Chief of the Audit Resolution Branch was vehemently opposed to the settlement and wanted to keep IADE on reimbursement until there was a final audit determination. Other offices, including the Regional offices and the Compliance and Enforcement Division, also opposed a settlement. An internal Department document related:

> 5/16/94—placed on reimbursement again, based on IRB and OIG audit findings (mostly ATB issue; potential $1.3 million liability?). This is the school that the Nunn Committee took an interest in. Ken Williams, corporate financial aid director, vehemently and irritatingly, complains by telephone and in a series of letters. School offers $500,000 letter of credit against liability if we will take off of reimbursement. No program office wants to accept offer, but *Steve Kraut, OGC, does so unilaterally*, despite our protests. [emphasis in original]

The General Counsel's acceptance of a settlement seems to have been driven by the fact that IADE had filed for a Temporary Restraining Order against the Department's imposition of the reimbursement order. It appears that the General Counsel was either unwilling to litigate the issue against IADE or afraid of litigating and losing. It therefore accepted the letter of credit in satisfaction of any liability IADE might owe under the final audit determination. What is not clear, however, is why the General Counsel was willing to accept a letter of credit of only $500,000 in satisfaction of an audit finding of $1.3 million.

The Staff recently spoke with Ken Williams, the former Financial Aid Director at IADE and the driving force behind getting the school removed from reimbursement in June 1994. The thrust of Mr. Williams' comments were that IADE had managed to get away with deceiving the Department about its true financial condition. He admitted to the Staff that in retrospect the Department should not have removed IADE from reimbursement. According to Mr. Williams, the fact that IADE had problems with late refunds and was consistently issuing checks for students twenty-one days in advance of their start dates should have indicated to the Department that this was a school with a serious cash flow problem.

With respect to refunds, Mr. Williams admitted that prior to the Inspector General audit, IADE had not been making any refunds. Only the threat of the impending audit forced IADE into clearing the backlog of refunds due. Apparently, the Stofenmachers calculated that it would be better for an audit to find IADE making late refunds than for it to find IADE making no refunds at all. Mr. Williams told the Staff the only reason they were able to get away with this was because the school had some 3 weeks advance notice of the audit. Mr. Williams suggested that if the Department conducted unannounced audits and reviews they would "catch a lot of schools."

Mr. Williams also suggested that the Department conduct unannounced limited-scope follow-up audits 6 months after an initial finding that a school is making late refunds. This type of follow, he said, would catch many schools actually making no refunds. Indeed, Mr. Williams admitted that such a follow-up would have uncovered that IADE was not making refunds.

Since no such follow-up was undertaken, IADE was able, once again, to return to business as usual after being removed from reimbursement in June 1994. Things also appeared to return to business as usual within the Department—no further attention was paid to IADE and a final audit determination letter still had not been issued. In August 1994, however, IADE once again came to the Department's attention. On August 24, 1994, the Department's Office of General Counsel received notification by letter from the Department of Justice that it was looking at IADE as a possible civil fraud matter. A copy of this letter was also sent to the Counsel to the Inspector General.

Despite receiving this notification, the Department took no steps at that time to place IADE back on reimbursement or to otherwise limit its access to federal funds. In fact, it appears that the General Counsel's office never even informed the Compliance and Enforcement Division about this notification until March 1995, some 6 months after the notification had been received. The Inspector General likewise appears to have undertaken no immediate response. It did ultimately open an investigation of IADE, but internal memoranda reveal that this was not done until February 1995, 5 months after receipt of the Justice notification. During this intervening time period, IADE drew down another $6.6 million in Pell Grant funds.

In late February 1995, the Department received from a former IADE employee a copy of the Ken Williams memorandum to the Stofenmachers in which IADE's failure to pay refunds and improper administration of programs was discussed. This same employee had been cooperating with the Subcommittee for some time previously and had only recently resigned from IADE. It appears that with this information in hand the Department once again decided to place IADE on reimbursement. In doing so, however, the Department did not base its action on this information; rather it informed IADE that the action was being taken in response to the Department's receipt of the January 1995 CPPVE review of the IADE ESL program.

IADE's response to being placed on reimbursement again was to threaten suit again. In a letter to the Department dated March 6, 1995, the school objected to the Department taking this action based on what it called the "disputed findings" of a State program review rather than on the Department's own (still unresolved) audit findings. Moreover, IADE claimed that the $500,000 letter of credit had been established to protect the Department's interests pending final resolution of those findings and that the Department's actions in placing the school back on reimbursement violated the spirit of the original settlement.

Fortunately for the Department's General Counsel, it did not have to worry for long over whether to settle this matter with IADE. On March 9, 1995, the Department learned that IADE had shut down its main campus. On March 10, 1995, the FBI executed a search warrant of IADE's corporate headquarters in connection with the Department of Justice's criminal investigation, removing literally truckloads of documents. Three days later IADE filed for bankruptcy. In light of all this, the Department's Compliance and Enforcement Division, on March 24, 1995, issued an emergency action and notice of intent to terminate IADE on the basis of the school's bankruptcy and cessation of instruction.

By the time this action had been taken, Abraham Stofenmacher was already back in Argentina, Alejandro Stofenmacher had purchased a one-way airline ticket for Argentina, and Sergio Stofenmacher had driven across the border into Mexico (where he too allegedly boarded a flight for Argentina). More importantly, though, by the time of its demise in March of this year, IADE had obtained over $64 million in Title IV funds, including almost $58 million in Pell Grant funds alone.

c. The Mishandling of the IADE Case is Symptomatic of Deeper Problems Within the Department

For the past 5 years this Subcommittee has been examining the Department's ability to oversee the operation and management of this nation's federal student financial assistance programs. In hearing after hearing, evidence has been presented documenting problems of mismanagement, incompetence, indifference, lack of resources, lack of training, lack of personnel, and perhaps a lack of will. And time after time, the Subcommittee has heard from Department officials, under both Republican and Democratic administrations, that they are committed to reforming the process and improving the integrity of the programs they oversee. Certainly Congress has attempted to help the Department in this regard. The 1992 amendments to the Higher Education Act gave the Department significant new tools with which to address issues of institutional integrity and program fraud and abuse.

And, as the Staff noted in the Subcommittee's first hearing on the Pell Grant program in 1993, steps were taken within the Department to begin to deal with these problems. The Office of Student Financial Assistance Programs was reorganized, leading to the creation of the Institutional Participation and Oversight Service. This Service, known as "IPOS," was tasked for the first time with coordinating certification and eligibility, accreditation and State licensing, and program review and compliance operations within the Department. Several strong and committed managers were brought in to run the various divisions of the IPOS, and there seemed to be a renewed outlook by both senior management and mid-level career employees regarding their charge to ensure the integrity of student aid programs.

Despite the high hopes generated by the Department's new administration, the Staff must once again report to the Subcommittee about a massive failure on the part of the Department in carrying out its fiduciary role of ensuring program accountability, a failure which led to over $50 million of taxpayer money going to a school which was little more than a Pell Grant mill. What is most disturbing, however, is that the IADE case seems to be symptomatic of the Department's longstanding and continuing failure to accept its fiduciary obligations and to adopt a consistent and aggressive oversight mentality.

It is not the Staff's intention to paint all of the Department's employees with the same brush. There are many hard-working and earnest employees within all levels of the Department who are deeply committed to ensuring the integrity of the programs they administer. The Staff interviewed a number of such employees, all of them branch or division managers in the IPOS, about their own commitment and that of the Department. Unfortunately, the feeling among these employees was unanimous that the Department's approach to enforcement was uneven, inconsistent, and easily susceptible to outside pressures, both institutional and political.

For example, the Staff was told that the statutory requirement that institutions submit independent audit reports was "a joke" because the Department consistently had done nothing when an institutions failed to submit such a report. Indeed, as the Staff has previously reported in this statement, IADE never submitted a report due in March 1994. Even though the school continued to operate for over a year after that date, no action was ever taken by the Department in response to this compliance failure. The audit requirement is something that the Congress obviously felt was important—in the 1992 amendments the requirement was changed from one of a biennial audit to one of an annual audit. The Staff was informed, however, that there are approximately 3100 schools which have not submitted their required audits, going back in some cases more than 5 years. According to the employees interviewed by the Staff, until just last year when a new Chief of the Audit Resolution Branch was hired, no one in the Department had ever taken responsibility for ensuring that audits are submitted as required.

The resolution of audits has been a longstanding problem for the Department. The Staff was told by the former Chief of the Audit Resolution Branch, Johan Bos-Beijer, that when he began his job in February 1994 there were approximately 300 audits which were overdue and awaiting final determination, some dating back many years. An audit is considered overdue if it has not been resolved within 6 months of issuance of the audit findings. The problem of unresolved audits was an area of such concern that it was included in the Semiannual Report of the Inspector Gen-

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eral for the period of April 30, 1993-September 30 1993 and the Report for October 1, 1993-March 31, 1994.

From all indications to the Staff, Mr. Bos-Beijer was a dedicated manager who carried out his duties with a single-minded devotion to improving the operations and accountability of the Department. Moreover, he was extremely successful—by August 1994, only 6 months after he had assumed his position, Mr. Bos-Beijer had reduced the backlog of unresolved audits from three hundred to only twenty. Success, however, did not come without a price. The Staff learned from a number of sources that the reaction Mr. Bos-Beijer and some of his fellow managers received from their staff for holding them accountable for their work was both vehement and hostile. Telephone and computer lines in the Institutional Review Branch were cut, employees were harassed and intimidated, and Mr. Bos-Beijer and others received death threats. In one instance, copies of pages from a manual detailing the use of hand grenades were found in the work area of the Audit Resolution Branch. As these incidents continued, employees from other divisions who shared the common work area began to fear for their safety as well.

The problems within the office became so bad that both the Inspector General's Office and the Federal Protective Service were called in to investigate and Marianne Phelps, the Director of the Institutional Participation and Oversight Service, found it necessary to send a memorandum to employees stating that, "we . . . cannot tolerate such behavior." According to Mr. Bos-Beijer, though, he received little, if any, personal support from his Service Director or higher officials. He told the Staff that senior management within the Office for Postsecondary Education seemed more concerned with placating employees than they were with supporting a middle level manager who was viewed as tough, consistent, and aggressive. As a result of his perception that he had not been supported by senior management, Mr. Bos-Beijer asked to be reassigned out of the Audit Resolution Branch.

A number of employees were also concerned about the role played by the Department's Office of General Counsel. Frances Moran, the former Director of the Compliance and Enforcement Division, told the Staff that during her tenure she engaged in numerous battles with senior management and the General Counsel's office over enforcement issues and that, while she was ultimately able to prevail in most instances, she constantly had to defend, argue, and fight for the authority to exercise enforcement decisions. She told the Staff that the General Counsel consistently intervened inappropriately in enforcement matters (both for and against taking enforcement actions and appeals), that it viewed the program staff as incompetent and irrelevant, that it refused to share information on matters in litigation until forced to do so, and otherwise attempted to go beyond its role as legal advisor and control program decisions, particularly those involving settlement matters.

Ms. Moran also expressed concern that decisions emanating from the General Counsel's office lacked any sense of consistency, that General Counsel attorneys often contradicted one another, and that the office resisted issuing written opinions. Decisions appeared to be made in a vacuum, with no appreciation of the ramifications of certain decisions on overall enforcement efforts and little or no interest in discussing case outcomes with program officials until required to do so.

Mr. Bos-Beijer was also critical of the General Counsel's office. He stated that, from his experience, the position of the General Counsel always seemed to be to negotiate and to settle in order to make sure that the Department did not look bad, rather than to pursue the decisions of the program offices through appropriate lines of authority.

Jack Reynolds, former Director of the Institutional Monitoring Division, and more recently former Director of the Institutional Participation Division, and Lynda Folwick, who succeeded Mr. Reynolds as Director of the Institutional Monitoring Division, both told the Staff of similar problems. They stated that the General Counsel's office often pursued informal settlements of appeals with institutions, many times negotiating deals without the permission of the program office.

Mr. Reynolds and Ms. Folwick also told the Staff of what they perceived to be the Department's failure to apply the laws and regulations governing the student aid programs in a consistent and even-handed manner. In their opinion, senior management was constantly looking for ways to be viewed as "good guys" in the eyes of the entities they regulated. They were particularly concerned that senior management constantly sought ways to help schools get off of reimbursement (especially in the face of any overt or implied political presssure) rather than apply the law and regulations as written. As Mr. Reynolds put it, "if they could eliminate reimbursement, they would."

Mr. Reynolds told the Staff that he encountered difficulties in his efforts to apply the Department's certification regulations in an even-handed and consistent manner. As Director of the Institutional Participation Division, Mr. Reynolds oversaw

the Department's certification and eligibility procedures. He stated that there were a number of times when he had to go "head to head" with senior management over recertification decisions. Mr. Reynolds felt that schools which could somehow plead their case directly to senior management, sometimes with political influence, were often allowed to remain certified even when an objective approach would find that they did not meet certification requirements.

The Department managers with whom the Staff spoke were unanimous in their view that intense political pressure was sometimes exerted on behalf of certain schools in other areas as well, by federal and State officials of both political parties, and that it sometimes succeeded in obtaining preferential treatment for those schools contrary to the career staff's decisions and contrary to their view of the appropriate enforcement of the law. In particular, Ms. Folwick noted that political pressure appeared to dictate many of the decisions made with regard to program review, audit, and reimbursement cases.

In addition to a lack of consistency and even-handedness, Mr. Reynolds and Ms. Folwick also felt that the Department failed to pursue an aggressive enforcement approach. In this regard, they cited the reassignment of Lee Hardwick, the former Director of the Institutional Participation and Oversight Service. They told the Staff that they met with Mr. Hardwick shortly after he had been removed from his position in the IPOS. According to Mr. Reynolds and Ms. Folwick, Mr. Hardwick informed them at that meeting that he had been told by David Longanecker, the Assistant Secretary for Postsecondary Education, that he was being reassigned because he had been "too aggressive" and because he "took this oversight stuff too seriously."

Ms. Moran told the Staff that she had expressed her own concern that the Department was "going backward" in its enforcement position to Mr. Longanecker and Marianne Phelps, who had earlier replaced Mr. Hardwick as Director of the Institutional Participation and Oversight Service. Ms. Moran said that Mr. Longanecker and Ms. Phelps both assured her that the Department was not going backward and that they were committed to a strong enforcement position.

Mr. Reynolds and Ms. Folwick told the Staff of other areas in which they felt the Department was going backwards in enforcement. They were particularly concerned about the area of program reviews. Previous Department policy had always been to conduct program reviews with advance notice given to the institution under review. In May 1994, however, management within the Institutional Participation and Oversight Service, with the concurrence of the Department's regional branch management, decided to change that policy so that program reviews would be unannounced. As the Staff has noted in this statement, advance notice of various reviews allowed IADE to alter records and engage in activities designed to deceive reviewers. In fact, the reviews which were most successful in exposing IADE's abuses were the unannounced reviews conducted by its accrediting agency.

The decision to conduct Departmental program reviews on an unannounced basis took effect on July 1, 1994. Apparently this decision was not welcomed by the Department's senior management. Ms. Folwick stated that as soon as the new policy began to be implemented, Assistant Secretary Longanecker began to receive pressure from school associations to reverse it. In March 1995, barely 9 months into the new policy, Ms. Folwick was told by Marianne Phelps that she would be given 1 week to justify the effectiveness of the change or it would be reversed. Given the limited amount of time for which the policy had been effective, it was difficult to gauge its long-term impact. Regardless, Ms. Phelps decided that there was insufficient support for such a new policy and it was reversed. According to Ms. Folwick, before her Division had even had a chance to notify the regional reviewers of the reversal, Mr. Longanecker had publicly announced it.

Ms. Folwick was similarly concerned about the Department's actions with respect to its new Program Review Guide. This guide is utilized by the Department's program reviewers to direct them in what to look for when conducting a program review. The previous guide had become a public document and it was felt by many that institutions were able to use their knowledge of the guide to circumvent program reviews. When the new guide was compiled, there was thus a concern that it remain a non-public document, and that any attempts to obtain the guide under the Freedom of Information Act be rebuffed. Ms. Folwick told the Staff that Mr. Longanecker was concerned because the institutional community wanted the guide released, but the General Counsel's office had opined that release should be denied on the basis of an exemption to the Freedom of Information Act.

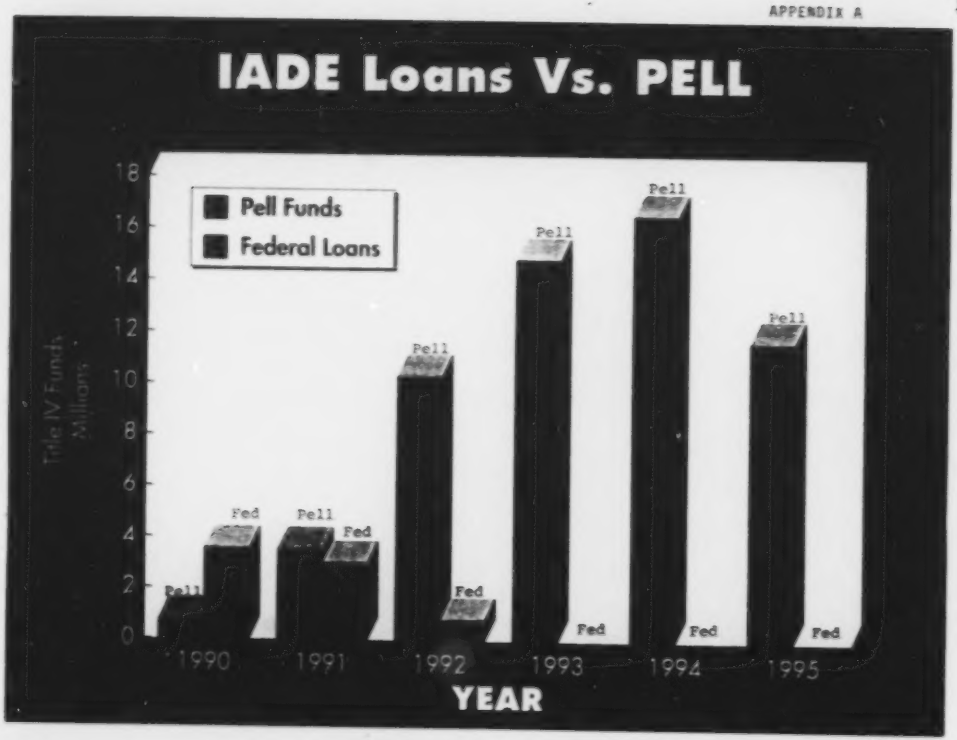
Mr. Reynolds and Ms. Folwick also expressed concern about the training provided to the Department's newly hired program reviewers. In its 1991 Report on Abuses in Federal Student Aid Programs, this Subcommittee found that "program review staff do not generally have any criminal investigative background or training and

. . . often do not recognize potential fraud or other criminal misconduct. . . ." According to Mr. Reynolds and Ms. Folwick, new program reviewers, while receiving better training than in the past, still do not receive any real training in detecting fraud. They stated that their attempts to bring in fraud and abuse examiners to provide specific training in this area to program reviewers in each region were rebuffed by senior management.

The Staff notes that both Mr. Reynolds and Ms. Folwick have also been reassigned in the last few months. Mr. Reynolds told the Staff that he was removed from his position as Director of the Institutional Participation Division by Assistant Secretary Longanecker. According to Mr. Reynolds, Mr. Longanecker told him, "you have had over a year to become a team player and have failed to take advantage of that opportunity." Ms. Folwick told the Staff that she was informed by Marianne Phelps that if she was not willing to go along with her approach she would be out as well. Ms. Folwick subsequently asked for reassignment, primarily because of senior management's failure to support her and other managers in their commitment to hold Department staff accountable and also because of senior management's resistance to a strong, consistent approach to oversight.

The information provided by these individuals is quite disturbing. While some may attempt to portray them as disgruntled employees who are purposefully attributing the worst possible motives to legitimate actions and decisions, the Staff notes that all of these employees appear to be dedicated individuals who were concerned not with their own standing and reputation, but with the standing and reputation of the Department. They are individuals who took on their positions determined to correct longstanding Departmental problems. They were charged with developing a plan to do this and it appeared that they were making progress in this area. Indeed, their career records reflect a history of outstanding performance ratings. They had turned the various divisions and branches of the IPOS into a team that was working together to bring a consistent and even-handed approach to oversight and enforcement. Whether the changes wrought by these managers will be continued under their replacements remains to be seen. The fact that these individuals were either relieved of their duties or felt it necessary to ask for reassignment gives the Staff great reason for concern.

The Staff must question where the Department stands with respect to its responsibilities for program accountability. Almost 2 years ago Assistant Secretary Longanecker appeared at this table and, as had his predecessors in previous hearings, assured the Subcommittee that he would strengthen the Department's monitoring and oversight efforts. Unfortunately, we are back here once again, with another multi-million dollar failure on the taxpayers' hands and the same old questions about the Department's capacity and commitment to hold accountable those who would abuse these important programs.



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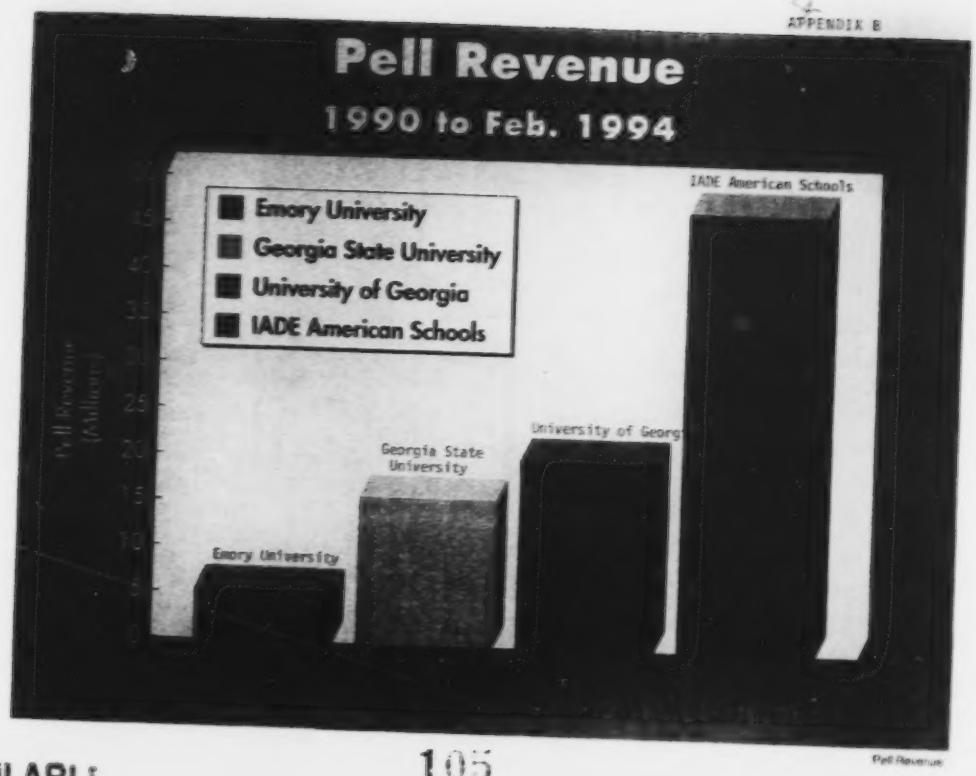

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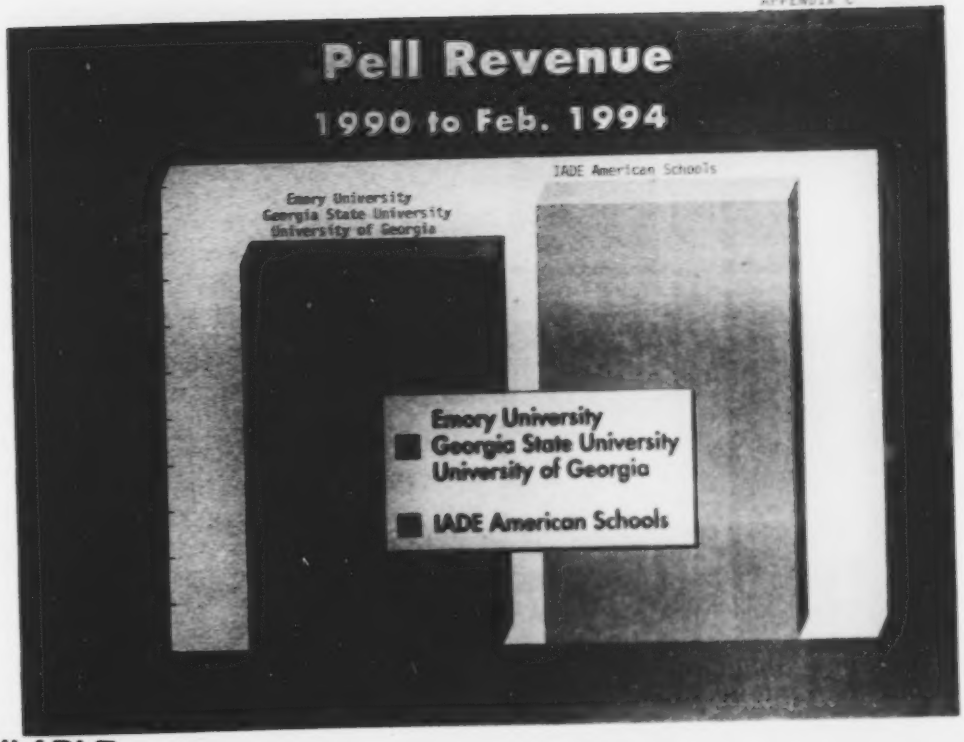

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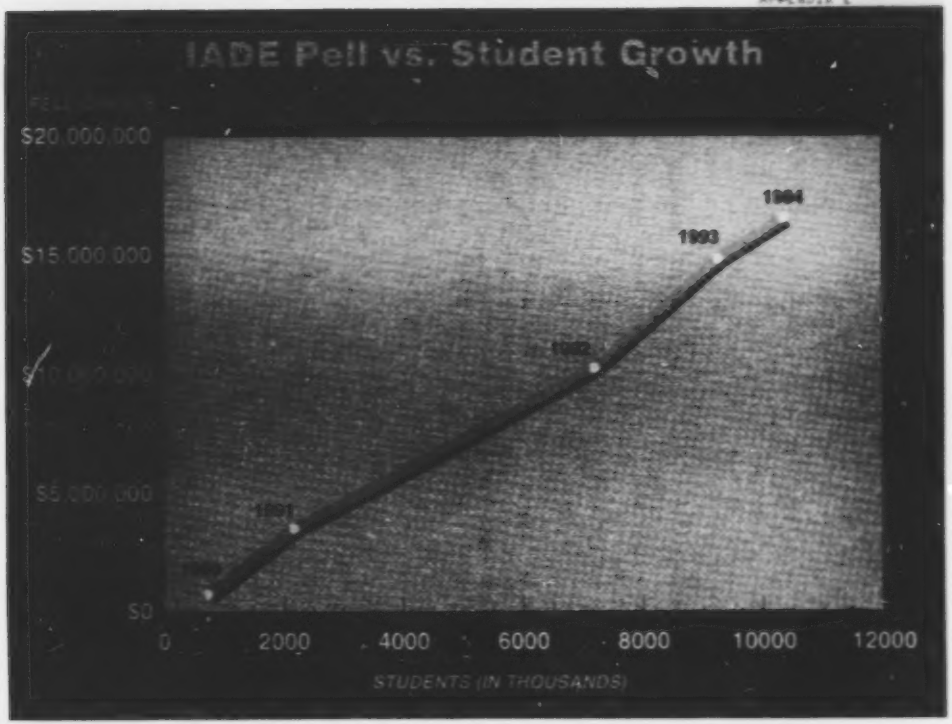
APPENDIX D

Graduate/Program	Job Title/Responsibilities
Edin, Computer Operations	pit boss in a casino (hired before IADE training)
Gabriel, Truck Driving	pipe fitter's helper
Jose, Computer Operations	packs bags
Veronica, Computer Operations	retail clothing store
Hector, Truck Driving	manages property
Carlos, Truck Driving	construction development
Yolando, Computer Operations	shipping and receiving
Jesus, Computer Operations	bartender
Everardo, Computer Operations	shipping clerk



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4 AMERICAN SCHOOLS

CAMPUS EL MONTE CAMPUS

APPENDIX F

START DATE FROM 02/09/94

NO SHOW LIST

STUDENT #	STUDENT'S NAME	PHONE #	*STATE	PROG.	*REPTENR.DATE
[redacted]	ARARA, MARIA G.	(818) [redacted] D		ESL-10	AFE 02/01/94
[redacted]	[redacted]	(818) [redacted]	E	ESL-10	RSA 01/11/94
[redacted]	[redacted], VIRGINIA M.	(909) [redacted]	E	ESL-10	AFE 02/02/94
[redacted]	[redacted], GUSTAVO	(818) [redacted]	E	ESL-10	AFE 01/18/94
[redacted]	[redacted], JOSE LUIS	(818) [redacted]	E	ESL-10	AFE 01/27/94
[redacted]	[redacted], JUAN E.	(909) [redacted]	E	ESL-10	AFE 02/02/94
[redacted]	[redacted], HUMBERTO	(818) [redacted]	E	ESL-10	RSA 01/05/94
[redacted]	[redacted], YOLANDA D	(818) [redacted]		ESL-10	RSA 01/28/94
[redacted]	C, E	(818) [redacted]	E	ESL-10	AFE 01/05/94
[redacted]	[redacted], JAVIER	(818) [redacted]	E	ESL-10	RSA 01/27/94

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APPENDIX G

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REM Inc.          AID MANAGEMENT SYSTEM      (0076)  11/11/94  1:09 PM  PAGE: 1
                        IST Los American Schools (El Monte)
              STUDENT MASTERSHEET                  Ref: 94 24076 A   02/01/94  LPC: 09/29/94 11:13:22  Att/stat: in-school

PERSONAL DATA:
NAME & S.S. No                          POPN    SEX ETHNIC MARITAL   FAM SIZE  CITIZENSHIP          ADDRESS & PHONE NUMBER
ARANA MARIA G [redacted]                05/19/50 F       unmarried  3         U.S. CITIZEN  1502 [redacted]
                                                                                                      [redacted]
                                                                                                      CA  91745        818[redacted]

ENROLLMENT DATA:
COURSE                          UNITS AC/YRLNK TRANSF ENROLL STARTED  END-DATE REV. END STATUS     HRS ADMISSION BASIS                Pay( Pr)
ENGLISH AS A SECOND LANGU        50   24  21      0      50 02/09/94 01/06/95 02/01/95 FULL TIME     2   ** A T B **                    2000
ENGLISH 2ND LANG/ESL-3C          36   24          0      36 02/09/94 01/06/95 02/01/95 FULL TIME     2 COURSE CHG W/C WITHIN 30 12/94   1200

ELIGIBILITY DATA:                                  PELL DATA
AWARD BASE FISAP FAM TAX EXPECTED   EFC    SAI   STUDENT SCHED EXPECT  DEPENDENCY
YEAR  YEAR   INCOME  NON INCOME                    COST   AWARD 0198    STATUS
92-94 1992   13034  TAX      0       0      0     5496   2200  2300    Independent

SAR RECEIVED RECORDS:
AY    SAI    EFC   VALIDATION:          ED REFERENCE:    TYPE:    SAR/ISAR  RECEIVED
94      0      0   accurate             256522871 AR 01  regular    ISAR.  02/07/94

PAYMENT DOCUMENTS SENT TO ED:                                                                                    *
AY BN   Paid:   To Pay:  Validation:  Revision:  Aut/Accept  Date sent  Date proc  Date batch  Err  Values:      Batch #
94 25   1150.00  1150.00      accurate  correct.:     2200.00  02/12/94  02/15/94  02/17/94                    94046771

FIN AID NEED:   AWARDS:

BUDGET  1 FDP   24.00 UNITS  02/09/94 09/16/94   7.00 MONTHS  32 WEEKS (15.18 MONTH ENROLL)
Food & Housing 4298.00  Transportation  532.00  Personal costs 1204.00  School charges 4600.00
        COST 10634.00              EFC     0.00              NEED 10634.00  UNMET NEED    8234.00
   PELL   2300 GSL      0 WORK      0 SEOG      0 CWS      0 PLUS      0  SLS      0 OTHER     0 AW YR
   1ST    1150 1ST      0 1ST       0 1ST       0                                              92-94
   2ND    1150 2ND      0 2ND       0 2ND       0                                              93-94

BUDGET  2 FDP   24.00 UNITS  09/29/94 06/05/95   8.00 MONTHS  36 WEEKS (15.18 MONTH ENROLL)
Food & Housing 4912.00  Transportation  608.00  Personal costs 1276.00  School charges    0.00
        COST  6796.00              EFC     0.00              NEED  6796.00  UNMET NEED    5741.00
   PELL   1150 GSL      0 WORK      0 SEOG      0 CWS      0 PLUS      0  SLS      0 OTHER     0 AW YR
   1ST    1150 1ST      0 1ST       0 1ST       0                                              94-95

PAYMENT PERIOD DATA:
  Required Start    End       Hours   Hours  Expect          Award     Expect    Amount    Payment
PP  Hours  Date:    Date:        PP per Week  Weeks Charges  Year  SAI  Disb  Scheduled  Status
01     0  02/09/94 06/09/94   12.00    2.29  15.05 1582.32   94     0  1150    1150.00  PAID
02    12  06/10/94 09/29/94   12.00    2.29  15.05 1582.32   94     0  1150    1150.00  PAID
03    24  09/29/94 02/01/95   12.00    2.50  17.99 1500.24   95     0  1150    1150.00  TO BE PAID

TUITION ACCOUNT:                                                                  SCHOOL          STUDENT
PP AY  Date:          Pay Status Tx# Description    check #    Charges  Credits   Balance
01 94 02/07/94  (02/09/94) PAID     40 PELL GRANTS   50682 02:           1150.00   1150.00-
       02/09/94                    20 TUITION                 1508.32             358.32
       02/09/94                    20 FEES                      75.00             433.32
02 94 06/09/94  (06/10/94) PAID     40 PELL GRANTS   55002 07:           1150.00    716.67-
       06/10/94                    20 TUITION                 1508.32             791.66
       09/29/94                    20 TUITION                 1508.34            2300.00

                                   TOTALS:                    4600.00   2300.00   2300.00      0.00
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PDS Inc.        AID MANAGEMENT SYSTEM      (0076)  11/11/94  1:49 PM  PAGE: 2

ARANA MARIA G [redacted]
99 95 09/29/94                    40 PELL GRANTS                    1150.00

                                        TOTALS:                     1150.00          0.00

REFUNDS DUE BALANCE (GLOBAL):
PP AY  Date:   Posted:  Pay Status    Description                Due      Paid   Balance

                                        TOTALS:                  0.00     0.00     0.00

MONTHLY ATTENDANCE:
(MONTH,YEAR,CUMULATIVE UNITS & GRADE)
06/09/94    12.00 A   06/23/94 S   12.00    09/28/94    24.00 A

ATTENDANCE STATUS CHANGES:
06/22/94  NEW STATUS: FULL TIME EXPECTED HOURS PER MONTH:    2.00   OLD STATUS: FULL TIME

SATISFACTORY PROGRESS MEASUREMENT SCHEDULE
             25%            50%            75%           100%           125%           150%
EXPECTED  05/02/94  12  07/30/94  25  11/05/94  37  02/12/95  50  05/21/95  62  08/27/95  75
POSTED                06/09/94  12  09/28/94  24
PERCENT          %            48%            64%            %              %              %

FORMS TRACKING:
Enrollment Questionnaire    AwYr: 94   received: 02/01/94   status: Received and Correct
AFSA Application             AwYr: 94   received: 02/01/94   status: Received and Correct
Verification Doc. done       AwYr: 94   received: 02/01/94   status: Received and Correct
Electronic App (AFSA)        AwYr: 94   received: 02/02/94   status: Batch # 0219
Electronic App (AFSA)        AwYr: 94   received: 02/02/94   status: Batch # 0219

Figures from Income Info:
Verif: Y          SAI: 00000  FC: 00000  Sec SAI:      Sec FC:       Aw Yr: 94  date: 02/07/94  kind: N  Stage 0: Orig sent
Automatic posting of 62, 20 and 26 done to
Handle conversion of courses.

**** THERE ARE NO C.A.T.'S PENDING
```

APPENDIX H

URGENT CONFIDENTIAL MEMORANDUM

THIS DOCUMENT IS TO SHARED WITH NO ONE OTHER THAN THOSE TO WHOM IT IS ADDRESSED AND HAS NOT BEEN PRESERVED ON EITHER FLOPPY OR HARD DRIVE

DATE: 7/14/94

TO: Abraham, Sergio, Bernardo, Alex, and Gonzalo

SUBJECT: Current Refunds

As you are each aware during the period between July 1, 1993 and June 30, 1994, because of IADE's tax loan and other financial constraints, IADE paid only a very small percentage of the refunds actually due the Pell Grant program during this period. The actual amount paid in refunds during this period was only **$284,866** for the entire award year.

As you are also aware, during this same period between 7/1/93 and 6/30/94 in order to increase cash flow we eliminated a number of checks and balances which allowed checks to print which would not normally have printed and/or items deposited into IADE's general fund. During this period for example:

a. students were transmitted to RGM's system and checks were printed based on "scheduled" rather than "actual" starts. Under the prior policy, we waited 45 days after the student had been enrolled to transmit data and print checks;

b. in some instances student data was transmitted and checks were printed based on estimated income and tax data rather than actual tax returns data. Under the prior policy data was not transmitted and checks were not printed until after the tax return, if filed, was actually received, and

c. Pell checks were printed even before it was confirmed that ESAR's had been signed by the student or other required signatures were obtained. Under the prior policy we confirmed that ESAR's were signed prior to the check being deposited.

Relaxing previously existing procedures allowed IADE to significantly increase cash flow in the short run. However, in the long run, the changes dramatically increase the amount of refunds due. For example, many of the students for whom we printed and deposited checks, should never have received any Pell funds at all. Consequently, as soon as the drop information is posted for these students, we will be forced to pay back ALL of the money we received for them. As I warned when IADE's senior management first decided to do this, the long term implications for refunds owed has been dramatic.

1. As of June 30, 1994 the total amount actually "appearing" as due in refunds is **$1,078,498**.

2. There are **$364,166.00** in additional refunds which were posted to the system as paid on March 8, 1994 when Barry Glasser was conducting the most recent biennial audit but which in fact have never been deposited. RGM has repeatedly asked us to provide the deposit slips on these refund checks and reviews our bank statements on a monthly basis to determine if the checks have cleared. It should be noted that the checks for these refunds were drawn on banks with which we no longer do business, it is currently impossible for us to deposit these checks into the Federal funds account. Given the tone of recent calls from RGM, I expect it will be only a matter of a few more days RGM, in order to protect its own credibility with the Department of Education, will delete these refunds from the system. This will increase the Refunds Due "appearing" on the system to $1,442,664.

3. In addition to those refunds appearing on the system, there are approximately 1,607 students who are no-shows, withdrawals, terminations, etc. who have not been posted to the RGM system as no longer enrolled. Approximately 75% of IADE's student's who drop trigger refunds. In turn, the average refund for due for each student for whom a refund is triggered is approximately $859. As such, these students when posted will create approximately **$1,035,310** in additional refunds, i.e., 1,607 x .75 x 859 = 1,035,310.

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4. The total projected amount of refunds actually due as of June 30, 1994, which includes both posted and non-posted refunds, is $2,477,974

5. The annual projected amount of refunds due for the month of July 1994 and for each month thereafter, assuming we return to the prior check printing safeguards (see a, b and c above), will be approximately $140,000 per month

6. These refund totals until paid will also create excess cash on hand in the exact same amount as the refunds due. It should be noted that unpaid refunds and excess cash on hand are the two most common reasons for the Department to place schools on reimbursement. If the Department were to take such action on these grounds it would be almost impossible for us to get it lifted even if we tried

Having summarized the problem, I would propose the following potential solutions:

A. Only available solution is to pay refunds. Real issue is how. The previously posted $1,676,498 is the most immediate priority since these amounts are currently showing as due and will affect our excess cash on hand until it is fully paid and which would be very easy to spot in a review or audit. Assuming available funds, I would suggest the following:

i. post $900,000 in refunds paid at the end of July 1994 and actually deposit $450,000 at that amount at that time;

ii. deposit the additional $450,000 the second week August 1994 and, during the last week in August, post the remaining $176,498 in refunds as paid to the system and actually deposit the checks at that time;

iii. also during the last week in August, re-post as paid and actually deposit the $364,166 which shows as previously paid but was never deposited on 8/31/94 so it clears in September. It should be noted, however, that should ROM as predicted delete the prior postings which show these funds as paid, we would need to pay it sooner since the implications for excess cash on hand would be significant;

iv. by September 1, 1994 approximately $280,000 in additional refunds due should have accrued. While the appearance of these refunds can be delayed until then, delaying posting much longer will leave us with the same problem we currently face. My advice therefor is that if financially possible these refunds also be paid by the end of September 1994;

v. during the six month period between 10/1/94 and 3/31/95 we should post one-sixth (1/6) of the drops 1,607 drops which have not yet been posted and paying any associated refunds. This should work out to an additional 268 drops showing up per month and should add about $172,552 per month in refunds during the period between 10/1/94 and 3/31/95. Added to projected refunds of about $140,000 per month, total refund payments during this month would total about $312,552.

According to the proposed payment schedule the monthly refund payments (not postings, but actual deposits) would be as follows: (The number is the month)

7 = $450,000	8 = $626,498	9 = $644,166	10 = $312,552	11 = $312,552	12 = $312,552
1 = $312,552	2 = $312,552	3 = $312,552	4 = $140,000	5 = $140,000	6 = $140,000

Larger payment are deliberately scheduled earlier in the award year both because of the urgency of getting these paid but also because cash flow is greatest between July and September, reduces somewhat between October and March, and then declines significantly between April and June.

2

It should be noted that it may be possible to cover some of these payments and postings such as an audit or two in four weeks. However, the greater the delay the greater risk we run in terms of audits, excess cash, reimbursement and/or earning our aid eligibility and/or license to operate terminated. Perhaps as significantly, because RGM is also required to undergo Federal audits, RGM has threatened that it might be forced to eliminate IADE's ability to post its own refunds. If this were to happen, we would actually have to provide deposit slips to RGM for each refund made and wait until they had the opportunity to post the refund as paid before it would show on the system. This would totally eliminate our ability to post refunds as paid before they really were. The implications for our ability to quickly "fix" things during an audit are obvious.

As an IMPORTANT aside, in order to prevent the appearance of excess cash on hand, it is also very important that IADE not draw down large amounts of Pell funds more than about five days from the end of each month and that we deliberately request cash which is LESS than the checks we have printed for the month. The amount we UNDER REQUEST should be the amount appearing on the refunds due report. For example if the refunds due report at the end of July 1994 indicated that $178,491 was due in refunds, we should REDUCE the amount of our cash request for the month of July by at least that amount. Reports can be generated which will give us a more accurate indication of by how much we should under request funds. The amount of the under request however could be obtained at the start of the following month.

Potential Result If Not Corrected

IADE will be required to undergo what are now annually required student aid audits and will, as we have already been admonished by the Nunc Commune, will be required to provide AUDITED FINANCIAL statements. These audits coupled with the audited financial statements will, given the auditor's familiarity with the RGM system, reveal the unpaid refunds. Even if we retained an auditor unfamiliar with RGM, the refunds would either be discovered during the fiscal review or would be discovered when the auditor, as required by Federal law, met with RGM. In fact, all an auditor would have to do at this point to discover the unpaid refunds would be to look at our bank statements for the period between 7/1/93 and 6/30/94. The statements would show no refund deposits except for $2% fee for the extra award year. They would show only Federal Direct transfers. Given the prior response of the US Department of Education and ACCET's prior concerns regarding our past refund problems. They would almost certainly move to revoke our eligibility and accreditation if it were discovered that we had failed to pay refunds after convincing them that we had solved our prior problems. Frankly, even once the refunds are paid, they are already late. As such, the longer we wait to pay the refunds the greater the risk to IADE. Our biggest dilemma is that though we could once again relax check printing procedures to generate more income in order to pay the $%% refunds, this would only create more refunds next year and make the problem worse assuming we could look at for another year which, frankly, we can't. Frankly, in light of the Nunc arrangement, if they discovered and could prove that IADE had deliberately hidden refunds and provided false information to Congress, IADE's senior management could face criminal prosecution. I say this not to scare you, but to point out as I have before that we have to fix this problem before it is discovered by some outside agency.

3

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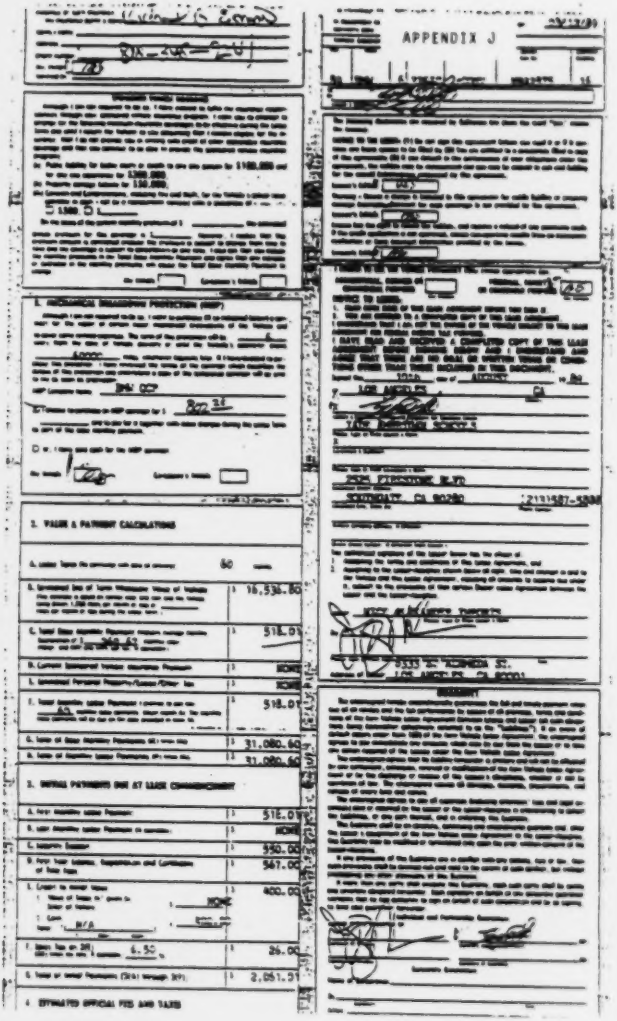
APPENDIX I

Payee	Number of Checks	Total Paid
Abraham Stofenmacher	8	$ 7,097.97
Alejandro Stofenmacher	11	$ 92,951.75
Bernardo Stofenmacher	11	$ 84,591.75
Sergio Stofenmacher	35	$ 161,483.50
Alley Parking	37	$ 112,050.00
Casa Management	40	$ 181,050.00
COTC	19	$ 41,650.00
IADE American Schools	100	$1,449,829.77
KMEX TV	12	$ 266,660.00
T&P Advertising	30	$ 262,920.00
Mercedes Benz	22	$ 14,144.72
BMW Credit Corp.	11	$ 5,283.70
District Attorney Child Support	13	$ 2,541.50
	Total	$2,682,254.66



APPENDIX J

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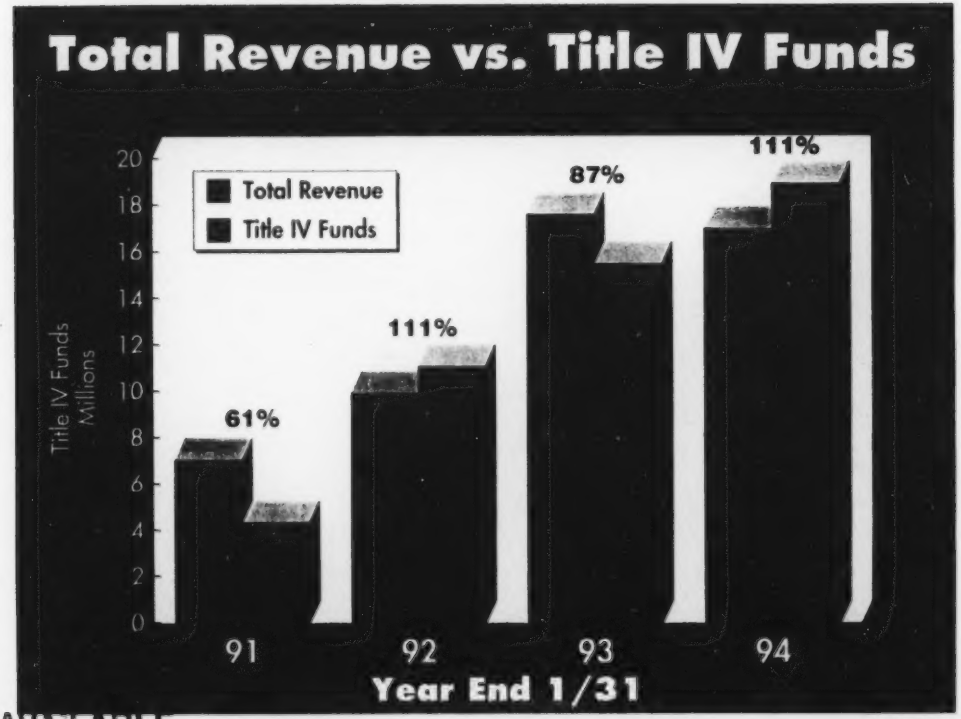

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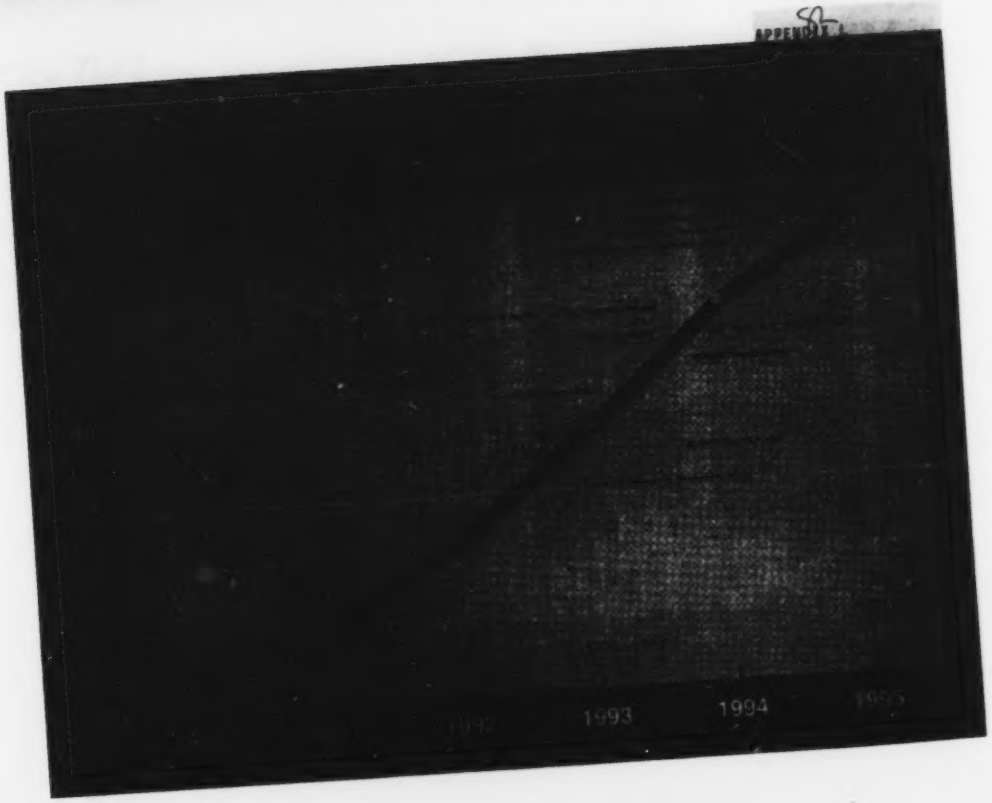

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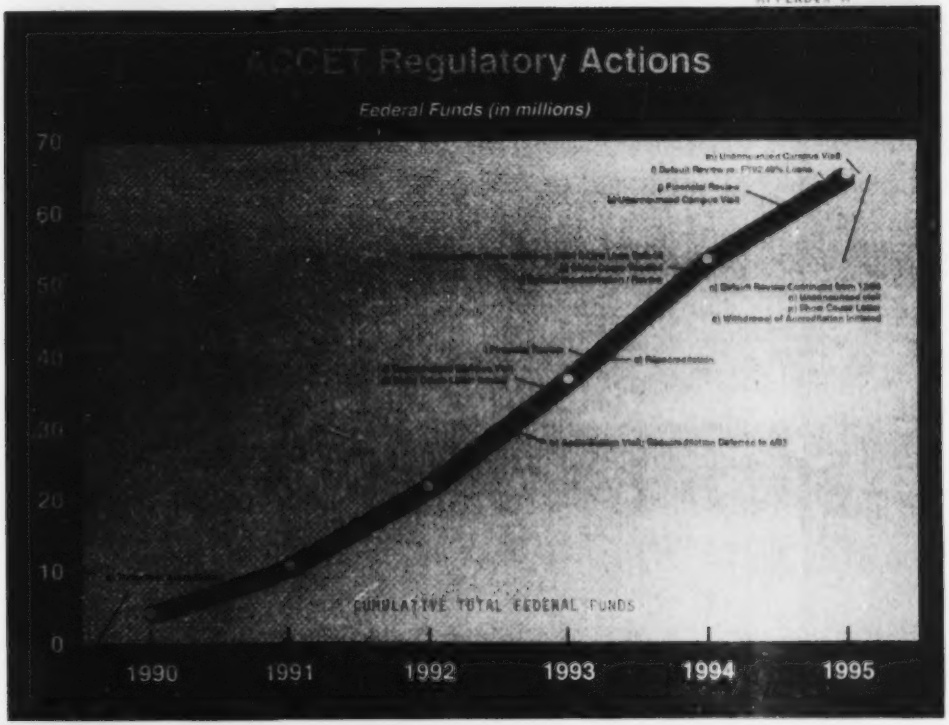

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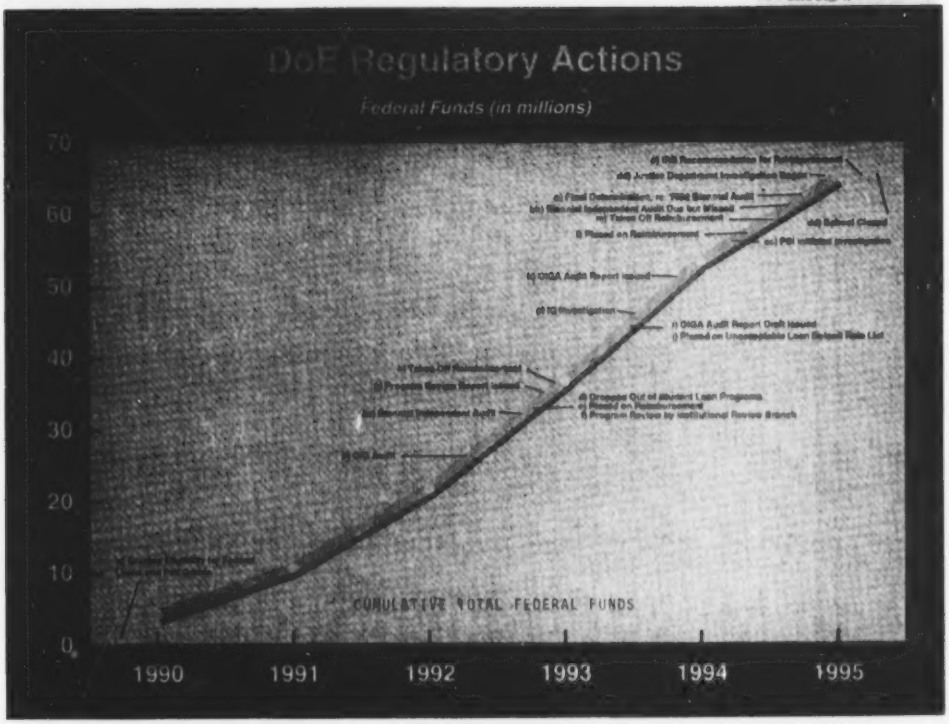
APPENDIX



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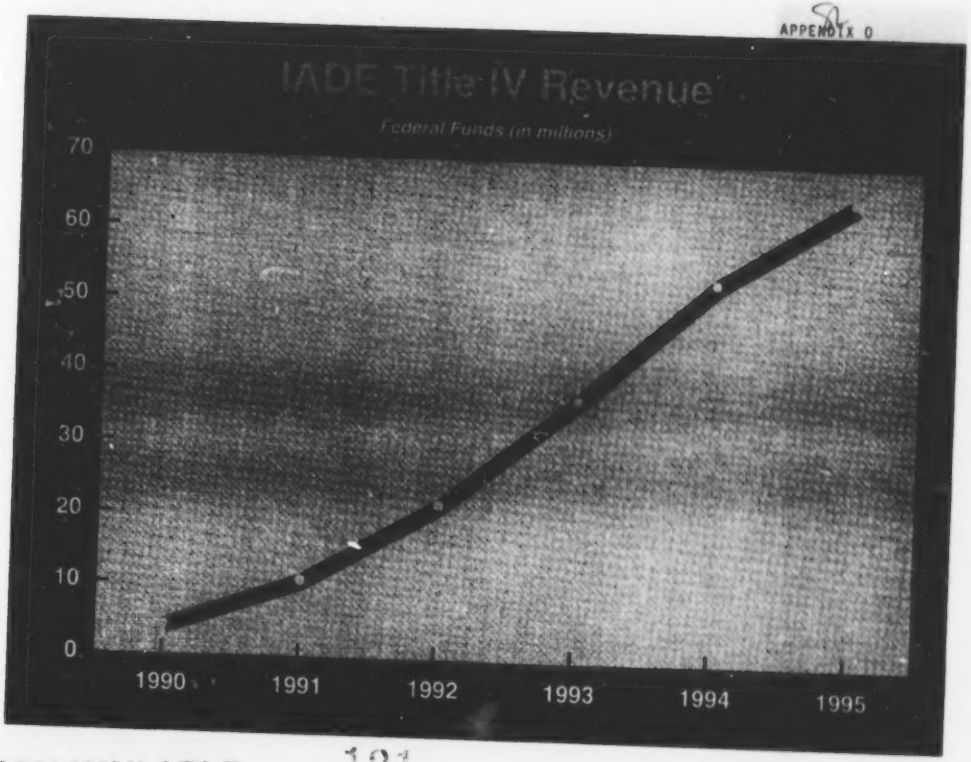
APPENDIX O



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PREPARED STATEMENT OF DAVID A. LONGANECKER

I am pleased to appear before you today to share with you the substantial progress we have made at the Department of Education to reduce fraud and abuse in Title IV, Higher Education Act student aid programs, as we said we would do in previous testimony before this Subcommittee. Our concern is the same as yours, that is, to provide deserving students the chance to improve their education while simultaneously ensuring the integrity of these programs.

We have worked hard to ensure that the institutions participating in our programs are complying with administrative and fiscal requirements as well as providing quality education and training to their students. We are doing a better job of focusing our efforts on the "high-risk" institutions that are most likely to be operating contrary to the program's goals and objectives. In the past 2 years, the percentage of institutions denied initial certification in the Title IV student aid programs has increased dramatically, as has the number of institutions removed from eligibility altogether. Furthermore, fewer schools are seeking initial eligibility to participate in our programs, which indicates that our tougher standards may deter some unqualified institutions from even applying for eligibility.

Despite the significant improvements we have made in our gatekeeping and oversight efforts, we believe that we can continue to improve our management of these programs. We remain committed to enhancing the effectiveness of our oversight responsibilities and to reducing the incidence of high-risk institutions participating in Title IV programs. In my testimony today, I will elaborate on the improvements we have made to ensure accountability for Federal funds in the student financial aid programs, and our continuing dedication to eliminate abuses in the future. Furthermore, I want to share with you a proposal to adopt a fundamentally different, and we are convinced, far better approach to oversight that would build upon our accomplishments of the last few years.

ELIGIBILITY AND CERTIFICATION

In the past, too many institutions that were financially weak, had low-quality programs, or were simply unwilling or unable to administer Title IV student assistance programs adequately were allowed to participate in these programs. To correct this problem, the Department and Congress have been working to improve the eligibility and certification process, and our efforts have paid off handsomely. For example, the percentage of initial applications for certification that has been denied has increased substantially, from 16.6 percent in 1990 to 30.5 percent in 1992 to more than 43 percent so far this year. [Charts, graphs, and a paper describing the existing gatekeeping system are attached at the end of the testimony.]

The Department is working with accrediting agencies to strengthen their oversight in statutorily mandated areas, in accordance with the Higher Education Amendments of 1992. Agencies that fail, in their accrediting of institutions, to apply meaningful standards to assess institutional quality (with an emphasis on curriculum), student outcomes, and ability to carry out institutional mission (in light of faculty, finances, facilities, and support services) will not be recognized by the Secretary of Education. Institutions that change accrediting agencies or try to "shop" for more lenient ones will not be allowed entrance into the student aid programs. We have also appointed an outstanding group of individuals to the National Advisory Committee on Institutional Quality and Improvement, which advises the Secretary on the Federal recognition of accrediting agencies.

Provisional certification of institutions is another new and important tool now being used to ensure that institutions are capable of effectively administering the Title IV programs. Schools that are at-risk or fail other criteria are placed on provisional certification and are then reviewed more carefully and frequently to ensure that they meet the financial and administrative standards established by the Department, as well as comply with all student aid rules and regulations. In addition, all new institutions are automatically placed on provisional certification. After the first full award year, each new institution must apply for full certification, at which time the Department determines, based on a thorough review of the institution's performance during its first year of participation, whether to grant full certification, continue provisional certification, or terminate eligibility. All institutions placed on provisional certification are subject to a system of expedited administrative review, which enables us to remove schools from participation quickly, before problems worsen. In all, about 600, or more than 8 percent of all institutions, are currently on provisional certification.

The Department has also begun the recertification process, instituted by the 1992 Amendments, whereby all institutions participating in Title IV programs must renew their certification every 4 years. This process will ensure that institutions

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continue to meet the standards of financial responsibility and administrative capability. As I stated to this Committee 2 years ago, we are focusing our initial efforts on the institutions that have previously posed concerns to the Department. Nearly 60 percent of the first 1,300 institutions undergoing recertification were selected because they met criteria that identify potentially at-risk institutions. Institutions that meet these criteria include institutions that were subject to an on-site review by either the Department or a guaranty agency in the past year; had high student withdrawal rates; or did not meet the financial standards based upon an initial screening of their financial statements. We realize that the recertification process creates some burden for the institutions, and we are working on ways to reduce this burden for high performing institutions as we continue to improve our management of the gatekeeping system.

MONITORING EFFORTS

Monitoring and program reviews are other essential components of oversight that we have improved substantially in the past few years. We spend considerable time and effort ensuring that students and schools comply with our rules and regulations using management controls, databases, and intensive reviews of at-risk institutions.

The Department's new Postsecondary Education Participants System (PEPS) has recently come on-line and will be able to provide interactive access and communication among the Department, accrediting agencies, States, and guaranty agencies. PEPS will dramatically increase the efficiency of institutional tracking and interagency communication and coordination, thereby strengthening the overall gatekeeping system.

In the last few years, the Department has also strengthened its monitoring of student aid applications to prevent ineligible students, and students who provide false information, from receiving Federal funds. A number of database matches are performed for each student aid application. First, beginning September 1994, each applicant's name and date of birth is matched with the Social Security Administration's master file to verify the applicant's Social Security number. When we last appeared before this Committee, we were checking merely to determine whether the Social Security number the applicant reported was within the valid range of all numbers issued by the Social Security Administration.

Second, as of January 1995, every applicant's name and Social Security number is checked against the Department's National Student Loan Data System (NSLDS) to determine whether the student is in default on a student loan, or has received an overpayment on a grant and therefore owes a refund, before he or she can receive additional aid. This new data system provides more timely, accurate, and comprehensive loan-level information than was previously available through the database of loans held by the Department and the default files of guaranty agencies.

Third, the Department verifies the eligibility status of applicants who claim to be eligible non-citizens by matching their alien registration number ("A" number) with the Immigration and Naturalization Service. Recently, the Office of the Inspector General (OIU) recommended that we expand the Social Security number match to include citizenship status in order to prescreen all applicants for citizenship status rather than only those who provide an alien registration number. We have moved forward with this recommendation and we expect to implement this match before we begin to process applications for the 1996–97 award year. Finally, the Department has, in the last year, begun systematically to identify students with scheduled Pell Grants in excess of the amount allowed by law. Such excesses occur when students transfer schools. The new check will help ensure that no such student will receive an overpayment.

We are also building on the accomplishments of the Direct Loan Program to use technological advances to consolidate our systems and processes. For example, we are redesigning the Department's financial and management information systems to ensure that data from accounting, grants, contracts, payments, and other "feeder" systems such as student aid are integrated into one financial management system. All of these measures will enable us to reduce our costs through the elimination of redundant and obsolete systems, reduce fraud and system vulnerability, and facilitate program flexibility and change as we expand our capability to quickly utilize new technologies.

The Department's monitoring of institutions was also assisted by the 1992 Amendments, which mandate the annual and timely submission of financial and compliance audits by all institutions. Previously, institutions submitted financial audits only after the Department detected a problem with their ability to meet the financial requirements. Compliance audits used to be required every 2 years. Although annual audits may be unnecessarily burdensome for high-performing institu-

tions, and we will propose ways to redress this, they are an important tool that enables us to review high-risk institutions' performance before serious problems arise. For example, findings in an institution's financial statement may lead us to conduct a program review, in which one of the Department's 10 regional offices reviews an institution's participation in the student financial assistance programs and initiates corrective action to ensure that the school is using proper procedures to award, disburse, and account for the use of Federal funds.

The Department performed 562 program reviews in 1994 and expects to perform 30 percent more reviews both this year and in 1996. To accomplish this goal, we have hired nearly 100 additional program reviewers and significantly increased the formal training we provide to them through our new Training Academy. This training encompasses a thorough understanding of student financial aid rules and regulations as well as some training on how to detect criminal fraud. In just the first 7 months of this fiscal year, 48 percent more staff were trained than in all of fiscal year 1994, and the number of hours spent in training increased 57 percent over 1994 levels.

The Department has also implemented other measures to better target high-risk institutions for program reviews, reduce the time it takes to finalize a review, and assess meaningful liabilities. By taking advantage of technological advancements, we have refined automated techniques used to evaluate school status and provide warning signals to identify high priority candidates for review; we have supplied staff with state-of-the-art portable computers and enabled them to access Pell Grant payment information to support review activities; and, in just over a year, we have made important improvements in the practice of statistical sampling so that our reviewers can make more sophisticated, scientifically designed assessments of the loss caused by institutional errors or abuse.

Enforcement Actions and Default Reduction Initiatives

When audit reviews, program reviews, or other monitoring devices indicate that an institution is failing to comply with requirements of Title IV programs, or that a school is otherwise at-risk, the Department can limit, suspend, or terminate an institution's participation agreement. In 1994, 191 termination actions were imposed by the Department, and 332 institutions, the most ever for a single year, were removed from participation in student financial aid programs.

The default reduction initiative has also proven to be a very effective tool in enabling the Department to end an institution's eligibility from one or more of the student aid programs when the institution's default rate exceeds certain statutory and regulatory default rate criteria. Because the statutory threshold has dropped from 35 percent to 25 percent over a 4-year period, the number of institutions removed from participation has increased considerably in the past few years. More than 200 schools have been made ineligible to participate in the Federal Family Education Loan (FFEL) program based on high 1992 cohort default rates. An additional 200 institutions have appealed their default rates, and it is anticipated, based on past experience, that many of these institutions will also lose eligibility. By comparison, only 82 institutions lost their eligibility to participate in the FFEL program based on high 1990 cohort default rates.

The student aid default rate declined from 22 percent in the 1990 cohort to 15 percent in the 1992 cohort. While most of the unacceptably high defaults continue to occur in the proprietary sector, it, too, has seen a reduction in its default rate from 41.2 percent in the 1990 cohort to 30.2 percent in the 1992 cohort. Overall default claims have declined more than 30 percent, from $3.5 billion in 1991 to $2.4 billion in 1994, despite the 33 percent increase in the volume of loans in repayment during the same period.

Through these measures, and our overall commitment to stronger gatekeeping, approximately 600 institutions have been removed from participation in all Title IV programs since this Administration came into office in January, 1993. This is more than 2½ times the number removed from eligibility in the prior 2½ years.

Recent Department Improvements to Improve Communication

Mr. Chairman, as described, we have made many important improvements in the gatekeeping system in the past few years, and we believe that the implementation of the 1992 Amendments goes a long way toward eliminating high-risk institutions from participating in our programs. But, as the circumstances surrounding the case of the IADE American Schools suggest, we can do even better. An area we can improve is our internal and external communications. To improve internal communication, the Office of Postsecondary Education (OPE) meets regularly with the Office of the Inspector General (OIG) and the Office of the General Counsel (OGC) to co-

ordinate our oversight activities and apprise each other of significant developments. We have numerous examples where this cooperation has helped to expeditiously detect criminality and terminate illegal operations.

In August 1993, for example, the OPE conducted a program review at Clark College in Lake Charles, Louisiana and, based on its findings, contacted the IG's office. The ensuing collaborative effort discovered that the institution had established and maintained false and inaccurate student records to fraudulently obtain Title IV funds. The Department imposed an emergency action shortly after this finding and within a month, a show-cause hearing was held, the emergency action was affirmed, and the Department terminated the institution from further participation in all Title IV programs. As another example of improved communication, 2 months ago, OPE and OIG worked with the State of Maryland to close General Communications Inc. in Rockville because of significant problems in administering their student aid programs, and helped place students in other programs at nearby institutions.

To improve external communication among the Department, the States, and the accrediting agencies—what we refer to as the program integrity triad—we have begun a joint effort to share information systematically to detect mismanagement and abuse early in the process, not later. For example, the Department sends weekly updates to accrediting agencies and the States when it takes action against an institution. In turn, accrediting agencies have accepted their responsibility and have recently reported potential problems at eight institutions. The Department has taken the leadership role in encouraging better communication with the other members of the triad to discuss how the triad is functioning and how it can be improved. In May, representatives of the Department, accrediting agencies, State licensing boards, and institutions gathered to discuss these issues. These meetings will continue in our attempt to facilitate greater communication among the triad members.

THE DEPARTMENT'S NEW APPROACH FOR OVERSIGHT REFORM

I want to share with you today our ideas regarding a very different approach to gatekeeping and oversight that will build upon our efforts during the past several years. Our decision to propose a fundamentally new approach to our oversight function is, in part, a response to the continuing abuses of the student aid programs, of which the IADE situation is an example. As you know, the 1992 Amendments enhanced the gatekeeping system by providing additional authorities to the States through State Postsecondary Review Entities (SPREs). Initial efforts to implement these statutory provisions suggested that the SPRE program was developing as anticipated, and would appropriately focus review only on those institutions that deserved greater oversight.

Creating the SPREs, however, changed the relationship between institutions and their State and Federal Governments so substantially that the overwhelmingly negative response from the postsecondary community created an environment that simply made it impossible to sustain the partnership we need to serve students well.

In most respects, the Department's relationship to schools in the student aid programs is a healthy and productive partnership. In others, however, the relationship requires us to be strong enforcers of the law and protective of students and the taxpayers. Our new approach will continue a balanced partnership between the Department, the States, and accrediting agencies, with the Department having a stronger role in managing the relationship among the three partners. This new approach will be based on three major tenets: (1) it will differentiate between for-profit and nonprofit institutions and between degree-granting and non-degree granting programs; (2) it will differentiate among institutions by their performance in Title IV programs to create a fairer system, improve the effectiveness and efficiency of our gatekeeping operations, and provide regulatory relief; and (3) it will ensure that prospective students are provided adequate information about institutions to make informed choices about which institutions and programs to attend.

In an effort to ensure fairness, current law and, more importantly, long standing departmental practice and Congressional intent, often require that all institutions be treated exactly the same. But, we have learned that this policy has been misguided. Institutions do differ, and they do so intentionally. Indeed, we believe that these differences are part of what makes our system of higher education so strong. We have also come to believe that treating different institutions differently respects the wide variety of types of institutions that are part of the educational system, and is actually a more appropriate approach to ensure fairness and to protect students and taxpayers than trying to treat different institutions exactly the same.

And from a practical perspective, we know that a disproportionate share of the problems we face with fraud, abuse, and mismanagement occur at the for-profit institutions providing short-term training. Thus, it simply makes sense to treat these

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institutions differently, and our proposal does just that by distinguishing between profit and non-profit institutions, and, as importantly, between degree and non-degree programs.

Our new approach will recognize high performance in all sectors, and reward it with reduced regulation, oversight, and administrative burden, so that we can spend our valuable and limited resources more closely scrutinizing the institutions that pose the greatest risk.

The last aspect of our new approach requires institutions to provide information about educational programs and student outcomes to prospective students in order to help them make more informed decisions about where to enroll. This will help to ensure that market forces work better to eliminate inadequate institutions and programs. The information provided by institutions will vary between degree and non-degree programs. For example, institutions that offer non-degree programs will be required to provide information on graduation and job-placement rates. Institutions will be required to report this information to State-run One-Stop Career Centers that will act as honest brokers of information and will be required to make this information available to prospective students.

We will implement as much of this proposal as we can through changes in regulation and by simply changing the way we do business. We will, however, need your support. There will be pressures from many quarters to soften the approach and limit our efforts to protect students and the taxpayers. Attacks on the so-called "85–15 rule" make that clear. We hope this Committee will be a valuable ally as we continue to focus our efforts more efficiently and to better target those institutions that deserve more oversight.

Other Statutory Changes Needed to Help Ensure Program Integrity

At the same time, we are identifying other, more modest, statutory changes that we believe would enhance the overall integrity of institutions participating in Title IV programs. First, the Department recommends broadening the scope of Section 498 of the Higher Education Act to require a personal financial guarantee against liabilities from the owner of any proprietary institution that is placed on provisional certification. The statute currently allows the Department to require personal guarantees from an institution's owners only *after* a currently-participating Institution has demonstrated problems. This proposed change would protect the financial interest of the public by requiring financial guarantees from owners of institutions that have been specifically identified, through provisional certification, as being high-risk. This type of personal commitment is the same commitment a responsible bank official would demand in making a loan to these schools, and it would motivate the owners to exercise greater care and supervision of their managers and employees, and to provide students with higher quality services.

Second, we recommend that the individuals with financial authority and responsibility at institutions be held personally liable for an institution's unpaid refunds. In this respect, we would treat the institution's financial officers the same way the Internal Revenue Code treats a corporation's financial officers who fail to pay withholding taxes.

Third, the Department strongly recommends against delaying again the requirement that for-profit institutions generate at least 15 percent of their revenue from non-Title IV sources. The Department believes that the implementation of the "85–15 rule," which arose out of the 1992 Amendments, will have a significant positive effect on the quality of trade school training. Congress deferred the requirement last year and we are aware of various efforts to delay implementation again, or to diminish the law and accompanying regulations in other ways. While we fully support the 85–15 law, we would propose that high graduation and placement rates be used as mitigating circumstances so that high-performing institutions that are unable to meet the requirements of the 85–15 authority will not automatically be declared ineligible. Similarly, we intend to ensure that proprietary institutions do not circumvent the intent of the legislation simply by switching to non-profit status.

Finally, we want to hold institutions that unsuccessfully appeal high cohort default rates liable for the default costs and subsidies that are paid by the Department on loans made to that school during the appeal process. Currently, institutions may, with impunity, continue to receive loans during the appeal period. Our proposal would also require a school that chooses to receive loans during the appeal process to post surety in an amount sufficient to cover these costs.

Conclusion

Mr. Chairman, we recognize and take seriously our responsibility to maintain the integrity of the student financial aid programs, and believe we have made signifi-

cant improvements in the existing gatekeeping system. Our hard work in implementing the regulations arising from the 1992 Amendments and in improving the management of these programs has helped to significantly reduce the number of high-risk institutions that are participating in the Title IV programs, while continuing to provide access to postsecondary education for students who would not otherwise continue their education after high school. Indeed, $30 billion will be provided to students enrolled at 7,200 different institutions this year. While the amount of aid is more than ever before, the number of participating institutions represents a 15-year low. Simply put, more and more unqualified schools are being denied entrance into Title IV programs, and those that are accepted are being monitored more closely to ensure that they operate within the boundaries of financial and administrative responsibility.

Mr. Chairman, we will continue to do everything we can to reduce Title IV program abuse even further, and we appreciate your efforts to do the same. Whenever our investigations establish criminality, the Department will use all avenues available in order to seek prosecution of those involved. We look forward to continue working with you to ensure that the Federal funds appropriated to student financial aid programs are properly disbursed to the eligible students and institutions.

I would be happy to answer your questions at this time.

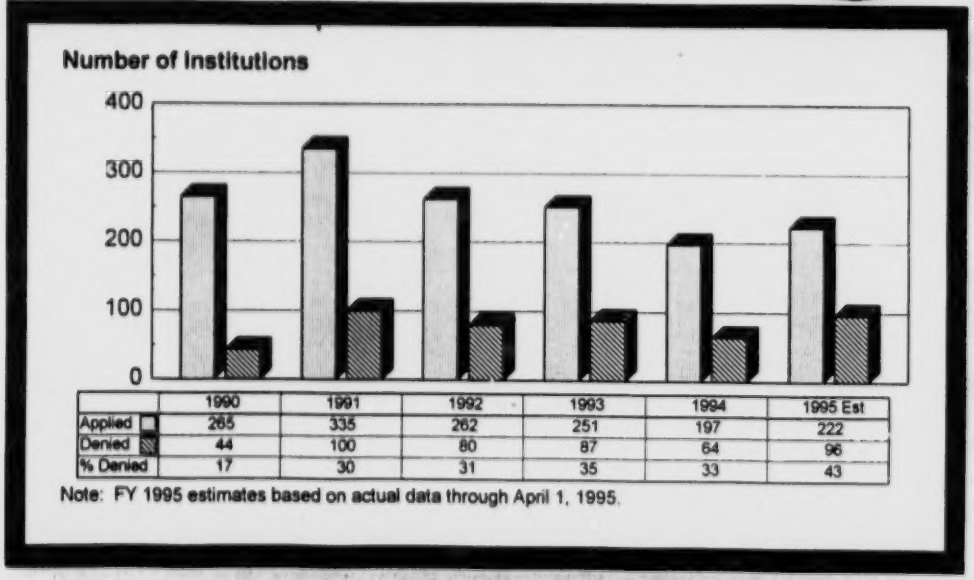
APPENDIX

Charts & Tables

133

Chart 1

Initial Institutional Applications to Participate in Title IV Programs

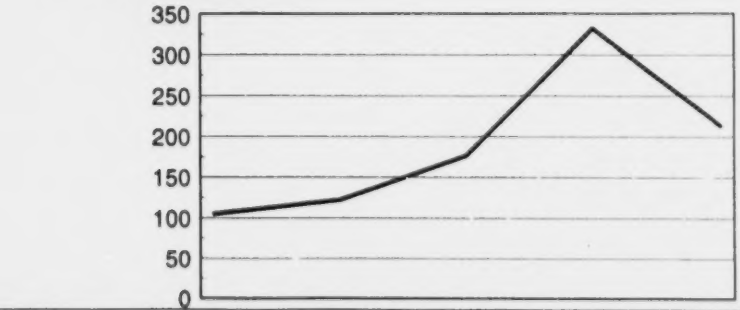


	1990	1991	1992	1993	1994	1995 Est
Applied	265	335	262	251	197	222
Denied	44	100	80	87	64	96
% Denied	17	30	31	35	33	43

Note: FY 1995 estimates based on actual data through April 1, 1995.

Chart 2

Institutions Removed from Title IV Participation



	1991	1992	1993	1994	1995 Estimate
Removed	105	122	176	332	213
Closures	67	66	80	141	151
Administrative Actions	38	56	96	191	62

Note: FY 1995 estimates based on actual data through May 1, 1995.

Chart 3

Distribution by Sector of Institutions Subject to Loss of FFEL Eligibility for High Default Rates

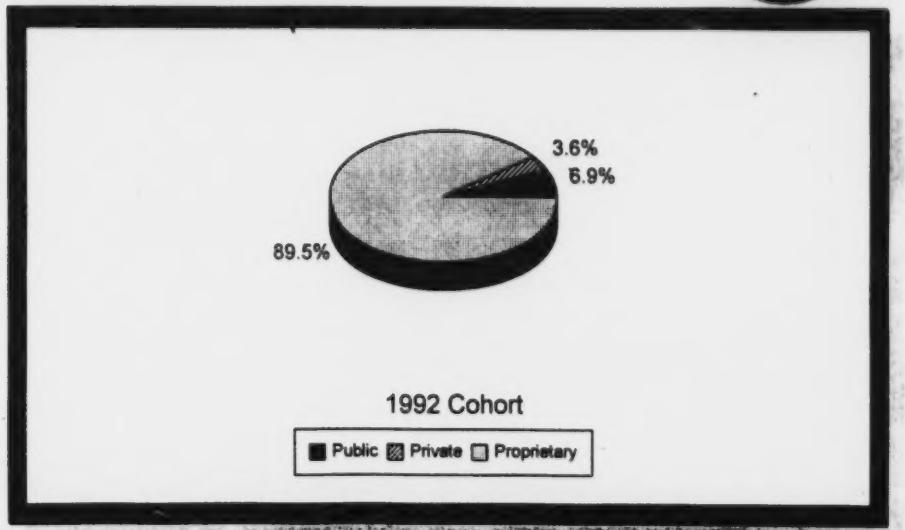


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Chart 4

Cohort Default Rates by Type & Control of Institution

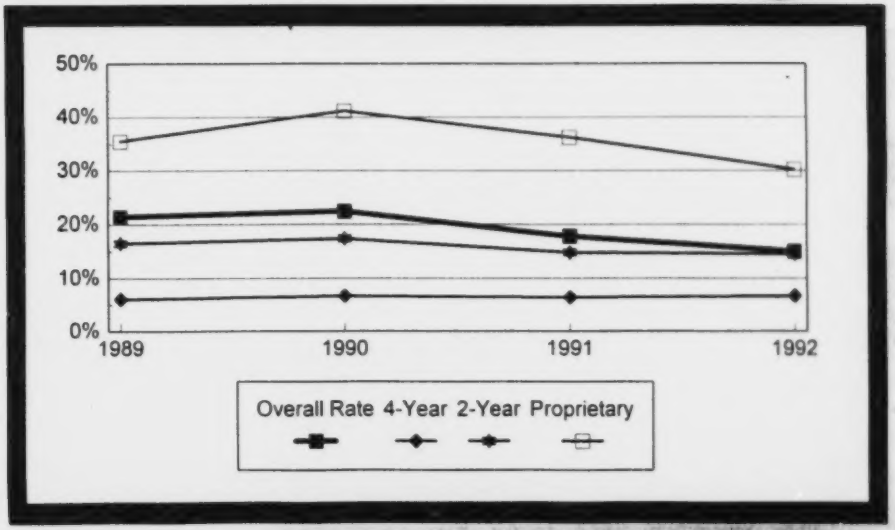

Table 1

Default Reduction Initiative
Number of Institutions Affected

Fiscal Year Cohort	Default Rates over Threshold	Made Ineligible	Remaining Eligible to Participate	Action Pending
1989	179	144	31	4
1990	109	82	14	13
1991	304	204	10	90
1992	449	217	7	225

Statement of

JOHN P. HIGGINS, JR.

Acting Inspector General

U.S. Department of Education

Before the

PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

Committee on Governmental Affairs

United States Senate

Regarding

FRAUD AND ABUSE

IN THE

FEDERAL PELL GRANT PROGRAM

July 12, 1995

Mr. Chairman and Members of the Subcommittee:

Thank you for inviting me to share with you the perspectives of the Office of Inspector General on fraud and abuse in the Federal Pell Grant program. I have been encouraged by the active role taken by this subcommittee in overseeing the Department's activities in general and this $6 billion student aid program in particular. I believe that the challenges facing all of us in providing quality education through this program can be met only with the full, active, and cooperative participation of all concerned parties.

The challenges facing all of us can be met only with the full, active, and cooperative participation of all concerned parties.

We testified before this subcommittee in 1993 about several problems in the Pell program. In summary, our earlier testimony explained that, by virtue of the program's design, the Department relies on the integrity of participant organizations and agencies to assure that grant awards are only made to eligible students, Federal funds are administered properly, required refunds are made, and expenditures are accurately reported to the Department. In our 1993 testimony, as well as our testimony before this subcommittee in 1990 on what are now called the Federal Family Education Loan programs, we also identified several problems in the "gatekeeping" process—the means by which postsecondary institutions are permitted to participate in the Pell Grant program and other Federal student aid programs, authorized under Title IV of the Higher Education Act (HEA).

The Department relies heavily on the integrity of participant organizations and agencies.

Much has been done to resolve the administrative problems we discussed regarding the gatekeeping process, and we want to credit the Department for its responsiveness in this area. However, more remains to be done to address the systemic problems we identified in the Title IV gatekeeping process and in the Pell Grant program itself. In addition to the unresolved problems identified in the two prior hearings, other problems have surfaced since 1993. In some cases, Congress will have to make legislative reforms to address these systemic problems.

Much has been done to resolve gatekeeping problems; however, more remains to be done.

Today I wish to focus on these systemic problems. In doing so, I will provide an update on the issues covered in our testimony in 1993, discuss additional concerns that have been raised in our recent audit and investigative work, and discuss a specific case that illustrates many of these problems—IADE American Schools.

The following were major topics covered in our 1993 testimony that I will update for you today:

- The Title IV gatekeeping process;
- Oversight of the postsecondary institutions responsible for the day-to-day administration of the Pell Grant program; and
- Internal departmental controls over grant authorizations and payments to schools.

In 1993 we also discussed opportunities for improvement in the oversight of the Department's contracts for administering various components of the Pell Grant delivery system. Because of other priorities, such as the development of the new Direct Loan program, we have just begun

to review the current status of this component of the Pell program, and are not yet able to report our findings.

UPDATE ON ISSUES DISCUSSED IN THE 1993 TESTIMONY

Gatekeeping

The suitability of approximately 7,000 public, private non-profit, and for-profit institutions participating or seeking to participate in the student financial aid (SFA) programs, including the Pell Grant program, is determined by the State licensure, accreditation, eligibility, and certification procedures commonly referred to as the "gatekeeping" process. As we have reported and testified to on many previous occasions, this gatekeeping process has proven insufficient in keeping financially and/or educationally weak and unscrupulous schools out of the SFA programs.

The gatekeeping process has proven insufficient in keeping financially and/or educationally weak and unscrupulous schools out of the SFA programs.

ACCREDITATION

In our testimony before this Subcommittee in 1993, we stated our belief that the then recently reauthorized Higher Education Act would provide the legislative framework needed for the Department to hold accrediting agencies more accountable for ensuring the quality of education provided by schools they accredit. We noted further, however, that because membership appointments had not been finalized to the National Advisory Committee on Institutional Quality and Integrity (NAC), the body responsible for advising the Secretary regarding accrediting agency recognition, it was not possible to evaluate application of the new tougher standards provided by the 1992 HEA reauthorization.

While we are encouraged to report now that the Department moved expeditiously to promulgate regulations necessary to implement the new statutory standards and the NAC is currently operational, our recent review of accrediting agency plans for implementing the new standards suggests delays in utilizing the tougher accrediting standards. Details of this review are provided later in my statement.

Our recent review of accrediting agency plans for implementing the new, tougher accrediting standards suggests delays in utilizing the standards.

INSTITUTIONAL ELIGIBILITY AND DEPARTMENTAL CERTIFICATION PROCESSES

In our 1993 statement, we discussed three audit reports issued between 1989 and 1991 that focused on the institutional eligibility process, the administrative certification process, and the financial certification process. Numerous recommendations from these three audit reports were addressed in the 1992 amendments to the Higher Education Act, thus providing the Department

with greater ability to screen out institutions that abuse the Title IV programs. Implementation of the new law became effective with the issuance of the final regulations in 1994.

Each year since 1989, the Department has recognized that the gatekeeping process was a high-risk area and reported it as such in their annual Federal Managers' Financial Integrity Act self-evaluation report to the President and Congress. Because of the Department's reported corrective actions and the expanded authority under the HEA of 1992, we conducted follow-up work to assess the effectiveness of the improvements to the gatekeeping process. We concluded that the Department had taken action to correct many of the problems we had presented in our three audit reports. For example, the Department has:

The Department has taken action to correct many of the problems presented in our three audit reports.

- Implemented several key regulatory changes to prevent high-risk institutions from entering the student aid programs.
- Started the conversion of their old institutional data base system to a more effective and efficient data base management system.
- Implemented a more rigorous review and analysis process of institutions' financial statements during the certification and recertification process.

While the Department has made numerous improvements in the gatekeeping processes, there are still certain key areas where corrective action is in process but not yet completed. Some of the operational weaknesses that need to be addressed are as follows:

Delays in implementing recertification plans will make it difficult for the Department to meet its statutory deadline.

- Implementation of the plan to recertify all institutions by 1997 did not begin until 1995, which will make it difficult for the Department to meet this statutorily required deadline. We recommended that the Department focus its staff resources on recertifying the high-risk institutions and devise a streamlined approach to recertifying the low-risk institutions.
- There still remains a problem keeping track of the institutional files. As in previous reviews, the Department could not locate all the files we requested. In our most recent review, they were unable to locate approximately 14 percent of the files we requested. While the Department had upgraded their file maintenance, they still need to implement tighter controls over file circulation.

Oversight of Title IV Institutions

We reported to this subcommittee in 1993 that we had in-process a performance audit to evaluate the Department's institutional review process. We had initiated this audit because of the significant role that participating schools play in ensuring effective day-to-day administration of the Pell and other programs on campuses.

In December 1993, we issued our audit report entitled, "Report on the Effectiveness of the Regional Institutional Review Branches' Monitoring of Institutions Participating in the Student Fi-

nancial Assistance Programs." This performance audit evaluated the efficiency and effectiveness of the operations of the Department's regional oversight of participants in the SFA programs. We recommended changes to the mission, structure, hiring, and training practices of institutional review offices; better targeting of institutional reviews; establishment of performance standards for reviews; enhanced computer utilization; and establishment of reporting standards, which together will increase the return on limited Departmental resources.

The Department's Office of Student Financial Assistance (OSFA) agreed with our recommendations, provided us a corrective action plan, and has initiated implementation of many of the improvements we recommended regarding their oversight of schools.

ED Grant Authorization and Payment Systems

As we testified during the October 1993 hearings before this Subcommittee, we had begun a survey of the Pell Grant system and identified audit areas with potentially serious control weaknesses. These audit areas included: student application errors, the initial authorization process, Pell Grant refunds and repayments, close-out and reconciliation of institutional Pell Grant accounts, and the performance of Pell system contractors. At this time, we have completed a review of selected student application edits and a review of the Pell Grant close-out and reconciliation process. Additional audit efforts in the other areas are planned, or have begun.

In September 1994, we issued an audit report that addressed the control structure over the citizen verification process that would prevent ineligible, non-U.S. citizens from participating in the Pell Grant program. For award year 1992-93, we compared the citizenship status of all Pell Grant recipients who had claimed U.S. citizenship with the Social Security Administration's (SSA) computer database and found that, based on SSA data, over 45,000 were not U.S. citizens. These ineligible recipients were awarded $70 million in Pell Grants and another $45 million in Stafford Loans.

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We recommended that OSFA strengthen its existing citizenship verification process by confirming the citizenship status of all student aid applicants with the Social Security Administration. We are now working with the Department and SSA to effect this improvement prior to the 1996 Pell award cycle.

Also in September 1994 we issued a report on our review of Pell Grant close-out practices and procedures administered by the Office of Student Financial Assistance. Our review noted that, for award year 1991-92, over half the approximately 6,700 participating institutions submitted expenditure reports that contained discrepancies totaling over $356 million. We made specific recommendations which, if implemented, should strengthen OSFA's closeout policies and procedures and safeguard millions of dollars from possible misuse.

Over half the approximately 6,700 participating institutions submitted expenditure reports that contained discrepancies totaling over $356 million.

ADDITIONAL CONCERNS

Since the Subcommittee's hearing in 1993, we have completed much additional work concerning the Pell program. While this work has revealed many improvements in the Department's management of this program, it has also given rise to additional concerns. For discussion purposes I have grouped these concerns into those related to performance measures and standards, program changes needed to prevent abuse by trade schools, and fiscal changes needed to prevent abuse by trade schools.

Performance Measures & Standards

The lack of measurable, outcome-oriented program goals and the resulting lack of adequate program performance information are fundamental problems of the Pell Grant Program and the other Title IV student aid programs. The following examples, which are based on work we have done since 1993, illustrate the nature of these deficiencies.

The lack of measurable, outcome-oriented program goals is a fundamental problem of the Title IV student aid programs.

ACCREDITING AGENCY STANDARDS

Through the Higher Education Amendments of 1992, Congress established several provisions to correct gatekeeping deficiencies. One of the most important of these provides for performance standards that would, for the first time in the history of the Title IV student aid programs, define measurable objectives and thereby establish much needed clarification of the purpose of the programs. Under the new statutory provisions, accrediting agencies that want to be recognized by the Secretary of Education as reliable authorities regarding the quality of education offered by the schools they accredit—and thereby participate in the Title IV gatekeeping process—must develop institutional quality standards in such areas as student course completion, State licensing examination pass rates, and job placement rates.

In order to assess progress in the development of these performance standards for student achievement, we recently conducted on-site reviews of five agencies that accredit institutions providing vocational training programs under Title IV. These agencies were selected for review because the institutions and programs they accredit are, by statute, eligible for student aid for the purpose of providing students the skills necessary to obtain gainful employment.

Overall, our reviews concluded that the accrediting agencies had made little progress in developing and implementing the new, congressionally mandated performance standards. One of the five agencies had established a quantitative job placement standard. However, since it did not have an adequate system for verifying the self-reported data submitted by its member schools, the standard was of limited usefulness.

Accrediting agencies have made little progress in developing and implementing the new, congressionally mandated performance standards.

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One reason for the slow progress accrediting agencies are making in this area is the fact that the final regulations for the new gatekeeping provisions were not published until April 1994. However, we determined that the most compelling barrier to progress is that agencies are reluctant to use performance data to assess the effectiveness of the job training programs they accredit. To do so would, in their view, put them in the position of being "government regulators."

Considering the findings of our review, we are doubtful there will be any meaningful reform in the accreditation process despite the statutory mandate for accrediting agency standards. We believe the Congress should consider legislating appropriate performance standards for schools participating in the Pell Grant and other Title IV programs.

State Postsecondary Review Entities

The Higher Education Amendments of 1992 also provided for new State Postsecondary Review Entities. In addition to being responsible for monitoring Title IV activities of postsecondary schools in their States, these entities would also be responsible for establishing acceptable measures for student achievement for participating Title IV schools. Although the Department worked deliberately to implement the SPRE program, absence of funding has prevented full program implementation. Without State Postsecondary Review Entities, this is no adequate mechanism for meaningful State oversight of the Title IV programs.

Usefulness of Title IV Vocational Training

As currently designed, the system of Title IV funding for vocational training affords little assurance that the training provided to students is helping them obtain gainful employment. Our reports issued in 1987 and 1993 noted that individuals were being trained, with a heavy investment of Federal funding, for nonexistent jobs. Our 1993 report pointed out that student aid programs are structured to make funds available to students without regard to labor market needs or to the performance records of schools. We believe that the statutory purpose of preparing students for gainful employment in a recognized occupation could be better accomplished and limited Federal vocational training funds more effectively used if the current funding system were fundamentally changed.

Our reports issued in 1987 and 1993 noted that individuals were being trained, with a heavy investment of Federal funding, for nonexistent jobs.

Under the current method of funding vocational training, a participating school can enroll as many students as possible and disburse as much student financial aid as is available. However, because there are no performance standards for student achievement, there is little incentive for a school to be overly concerned about how many of its students graduate and find jobs. School recruiters can promise glamorous, high-paying careers to prospective students, but graduates often receive much less than was promised. As we have previously noted in congressional testimony, our 1993 report found that of the 3,055 students who had been enrolled at the five schools we

Only 14 percent of the students enrolled at the five schools we reviewed had completed the training and received the required license to practice their new trade.

reviewed, only 432 (14 percent) completed the training and received the required license to practice their new trade.

Further, many students enroll in vocational training programs, incur significant debts, and then are unable to find work because they have been trained in fields where jobs are unavailable. These students often feel victimized and default on their student loans. They are ineligible for additional aid by virtue of their defaults and are thereby hindered in their pursuit of other education and career options. Students and taxpayers lose under this system.

Our 1993 report pointed out that it is time for funding approaches that would maximize the return on the SFA funds invested and provide incentives for schools to do better. It is not unreasonable to expect an adequate return on the billions of dollars in SFA funds invested in vocational training. Specifically, our 1993 report recommended that labor market needs and the performance of schools in graduating and placing their students be considered in SFA funding for vocational training. We also recommended that the Department take the lead in convening an interagency task force to study different funding approaches for vocational training.

It is time for funding approaches that would maximize the return on the SFA funds invested and provide incentives for schools to do better.

While the Department agreed initially with our recommendations, and we believe some action was taken in response to our report, it is unclear at this time what further action the Department plans to address problems identified in the report.

Programmatic Changes to Prevent Abuse by Trade Schools

Departmental efforts to prevent fraud and abuse in the Pell Grant program continue to be plagued by several programmatic deficiencies that allow trade schools to abuse the program. I have previously addressed them in earlier testimony before this subcommittee. I will address several that surfaced in connection with the IADE case on which this subcommittee is focusing in these hearings. Specifically, these program deficiencies relate to ability-to-benefit requirements, clock-to-credit-hour conversion, and English as a second language. Another issue I will address is Pell Grants for prisoners because a loophole in the law has recently become evident. For some of these issues, which are described below, the Department will need the help of Congress to develop effective solutions.

Efforts to prevent fraud and abuse in the Pell Grant program continue to be plagued by programmatic deficiencies.

Ability to Benefit

To be eligible for Title IV assistance, students without high school credentials must pass an approved test. The manner in which such a test must be administered and by whom has been a matter of some controversy over the years, leading to many statutory and regulatory changes. We have also found a great deal of abuse in the area of testing of students admitted on the basis

We have found a great deal of abuse in the area of "ability to benefit" testing.

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of their supposed ability to benefit from the training program, particularly by proprietary trade schools.

For example, some schools set a score below that recommended by the test publisher, which in our experience defeats the purpose of the test and allows students who cannot benefit from the training offered to be admitted. We have found this situation in several audits, including that in IADE. Recognizing the conflict inherent in letting schools themselves administer the test and set the score, since they have an interest in admitting the maximum number of students to collect the maximum amount of Federal aid, in the 1992 HEA Amendments Congress authorized the Secretary to specify the passing score on independently administered tests approved by the Secretary (section 484(d)(1)). However, the Department has not yet to publish final regulations implementing the provision. Therefore, the issue remains unresolved and the potential for abuse continues to exist.

Because the whole issue of admitting non-high-school graduates to Title IV-funded institutions has proved so problematic, particularly in the trade school area, we have started an audit to evaluate the success of such students in graduating from Title IV-funded training programs and becoming employed in the area for which they were trained. We hope to be able to provide the data to policy-makers for purposes of determining whether this provision of the Higher Education Act needs to be changed.

Credit-Hour Definition of Clock-Hour Training Programs

Trade schools are able to increase their Federal student aid receipts without adding significantly—if at all—to the instructional content of their courses.

Clock-to-credit-hour conversion is the practice among trade schools of changing the way they identify the length of their programs in order to establish eligibility for participating in the Pell Grant program and other Federal student aid programs, or in order to increase the amounts they receive through these programs. By using credit hours instead of clock hours for measuring their programs, trade schools are able to increase their Federal student aid receipts without adding significantly—if at all—to the instructional content of their courses.

The notion of credit hours, borrowed from the traditional academic world, is based on the assumption that students are performing substantial assigned work outside of the classroom. Accrediting agencies routinely approve clock-hour to credit-hour conversions without verifying that any significant outside course work is done and without requiring additional instructional material.

We have identified this issue in several audit reports and highlighted our findings in a summary report issued in 1990. However, our audit positions on this matter have not been upheld by administrative law judges because of a lack of explicit regulations on the definition of a credit hour. Eventually the Department published the needed regulations; however, in June 1994, before the regulations took effect, a Federal district court judge preliminarily enjoined their enforcement. The judge recently rendered his decision on June 16, 1995, concluding that, "Having determined that new regulations were neither arbitrary nor capricious, nor otherwise contrary to law, the court is bound to uphold them." It will now be incumbent upon the Department to

implement the new regulations. At the same time, the abuse has and will continue, to some extent, during implementation.

The Department asked Congress to resolve this matter through its reauthorization of the Higher Education Act in 1992. Subsequently, failing a statutory solution, the Department pursued the regulatory solution I have just discussed. During our testimony before this Subcommittee in 1993, we referred to this problem and the millions of dollars that had been wasted because of it. The following quotation from that testimony is as applicable today as it was in 1993, and underscores the intractability of the Pell Grant program's problems:

> . . . it may be inviting to think that, in the context of reinventing government or otherwise, we can do away with prescriptive regulations. However, we must be cautious when applying this approach in an area or to an industry where there is an identified pattern of abuse. While addressing the very real need to reinvent the way we are doing business, it is critical to focus on the safeguards needed to prevent abuse of taxpayer funds and students. The clock-credit hour conversion issue demonstrates that the easy availability of huge sums of Federal SFA funds provides motivation for some unscrupulous program participants to look for gaps in the existing laws and regulations in order to enhance their own financial interest rather than that of the students or the public. In rendering their decisions, courts will require that regulatory or legislative requirements are clear, and we must ensure that such requirements exist to protect taxpayers and the intended beneficiaries of the SFA programs.

English as a Second Language

In August 1994, we issued a report that asked the question, "Why Use Pell Grants For Instruction In English As A Second Language? Taxpayers Pay More and Students Get Less." Since the Department provides Federal funds for instruction in English as a Second Language (ESL) to adults under the Pell Grant program as well as under various federally funded Adult Education programs, questions are raised as to the comparative cost and quality of the instruction provided under each program.

". . . taxpayers pay more and students get less."

When Pell Grants are used for ESL, the education is provided by proprietary schools that charge between $4.77 and $10.00 per hour of instruction for a course of study lasting between 240 and 600 hours. ESL instruction funded by Adult Education programs is typically provided by local educational agencies and non-profit organizations. The costs per hour of instruction in those programs are significantly lower and the hours of instruction significantly higher than in those programs provided by proprietary schools with Pell Grant funding.

In addition to lower costs and more instructional hours, Adult Education programs expect students to achieve higher levels of English proficiency and have higher standards for instructor qualifications. We recommended that the Department ask Congress to eliminate ESL courses from eligibility under the Pell Grant program and, if needed, request additional ESL funding under the Adult Education programs.

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Pell Grants for Prisoners

The Higher Education Amendments of 1992 stipulated that schools whose enrollment of incarcerated students is at or greater than 25 percent are not eligible to participate in Title IV student aid programs. Subsequently, the Crime Bill of 1994 contained a general prohibition against the awarding of Pell Grants to prisoners. However, there are loopholes in these provisions that have permitted prisoners to continue to receive Pell funds.

Loopholes have permitted prisoners to continue to receive Pell funds.

The Higher Education Amendments authorize the Department to grant waivers to non-profit schools to permit them to continue to enroll large numbers of prisoners, and the Crime Bill has been interpreted as applying only to Federal and State prisons. Thus, as we have found in recent audit work, a school that enrolls prisoners from a county jail and obtains a waiver of the "25 percent rule" may continue to participate in the Pell Grant program. Unless the Department can address this long-standing problem administratively, additional legislative action will be needed.

Fiscal Changes to Prevent Program Abuse by Trade Schools

In addition to: 1) the need for measurable program goals and clearly defined performance measures, and 2) the need for congressional help in closing programmatic loopholes that allow trade schools to abuse the Pell Grant and other SFA programs, we believe that clear and enforceable program eligibility regulations are critical for maintaining program integrity and accountability. One key examples of this is the so called "85-15" rule and personal liability for school owners.

The "85-15 Rule"

This provision, which was passed by Congress in the 1992 reauthorization of the Higher Education Act, required that proprietary schools be able to attract at least 15 percent of their revenue from non-Title IV sources. This mechanism uses the market place rather than prescriptive Federal regulations as a means to ensure, to some degree at least, that the training offered is valuable and that the price charged Federal taxpayers is reasonable.

Before this provision could be implemented, Congress postponed its effective date to July 1995. We feel strongly that the provision would eliminate many trade schools that were created simply to take advantage of Federal largess rather than to provide quality vocational training, and would also serve as an incentive for reforming abusive practices in trade schools. We therefore hope that the effective date of this important provision will not, again, be postponed.

This provision would eliminate many trade schools that were created simply to take advantage of Federal largess.

School Owner Liability

It has proved very difficult, if not impossible, to collect program liabilities—particularly refunds—from corporate institutions that participate in Title IV programs. Owners of defunct or bankrupt schools typically walk away with tremendous financial gains while taxpayers and students are left with large debts. While Congress enacted a provision in 1992 to allow the Department

to require personal financial guarantees from owners and controlling individuals of schools participating or seeking to participate in the Title IV programs (section 498(e)(1)(A)), another provision added during conference has created confusion about the congressional intent, and the Department has failed to utilize the provision.

Owners of defunct or bankrupt schools typically walk away with tremendous financial gains while taxpayers and students are left with large debts.

At a minimum, Congress should clarify what we believe is a reasonable interpretation of Section 498. That is, that section 498(e)(1)(A) authorizes the Department to obtain personal financial guarantees from owners or controlling individuals of institutions that have participated in the Title IV program for less than 5 years, without regard to the factors listed in subparagraph (e)(4). This would protect the Federal financial interest for students that do not have a track record of responsible stewardship of Federal funds.

Clarification by Congress would protect the Federal financial interterest for students that do not have a track record of responsible stewardship of Federal funds.

A Recent Case of Program Abuse: IADE American Schools

We performed audit and investigative work at IADE American Schools (IADE) during 1992 and early 1993 and are currently conducting additional investigative work at IADE. Had the problems I have just discussed been resolved prior to our reviews of IADE Americans Schools, issues surfaced in those reviews would have been minimized. For example, IADE's improper administration of ability-to-benefit provisions cost the American taxpayer at least $1.3 million in just two years and abuse of clock-to-credit hour conversions cost the taxpayer $2.8 million in the same time period. Further, absence of owner liability provisions allowed IADE officials to retain ill-gotten financial gains.

IADE was a proprietary trade school operating in California and Florida. We initiated an audit of IADE due to the rapid increase in Pell Grants. Several allegations of fraud were received in the course of the audit. At the time of our IADE reviews, there was a very large caseload of investigations, including many cases similar to this one, and other high-priority cases were then being investigated that ultimately resulted in a significant number of indictments and convictions and the seizure of valuable assets. For example, during the IADE investigation our Los Angeles office issued five Federal seizure warrants to seize three commercial properties and two personal residences of the owner of a Long Beach, California, trade school.

As a result, although a criminal case was opened, it was not worked sufficiently. Instead, the audit continued and a large sample of student files was reviewed and several other tests were conducted to follow up on several of the allegations. The auditors kept the investigators advised of their results. The audit identified significant deficiencies in the school's administration of Pell, and recommended large dollar recoveries. It also provided the basis for a report to the Department, mentioned earlier, recommending that Pell funds not be used to fund ESL training.

However, it did not identify material evidence to indicate records falsification and found that refunds were being paid, but late. Given the nature of the audit conclusions, the decision was made to close the criminal case.

Since conducting these activities at IADE, we have made management and procedural changes to address the difficulties discussed above. I have made available to the Subcommittee specifics regarding these changes as well as descriptions of significant investigative cases we have worked since the IADE case. We are convinced, however, that protecting this program from those that would intentionally abuse it for illegal monetary gain remains problematic unless fundamental changes such as I have discussed here are implemented.

Protecting this program from those that would intentionally abuse it for illegal monetary gain remains problematic.

CONCLUSION

Mr. Chairman, this morning I have attempted to provide for the Subcommittee an overview of what are, in our view, the more significant issues regarding prevention of abuse in the Pell Grant program. Clearly, the Department has made strides to improve its management of this program, but critical systemic program weaknesses remain. Resolving these weaknesses will require Congressional action as well as continued attention by the Department. The Pell Grant program will continue to be a primary target for the work of my office, and we stand ready to assist you and the Department in any appropriate way to achieve needed improvements in this program.

Resolving these weaknesses will require Congressional action as well as continued attention by the Department.

Thank you. I will be happy to answer any questions you or other members have at this time.

PREPARED STATEMENT OF CORNELIA BLANCHETTE

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to present information on the U.S. Department of Education's Federal Family Education Loan Program (FFELP) and Federal Pell Grant Program. As you are aware, these are the largest federal programs providing financial aid to postsecondary students. In academic year 1994, they provided over $26 billion in loans and grants to over 10 million students.

During your Subcommittee's hearings in 1993, we testified on abuses in the Pell Grant Program.[1] Because of your continuing concerns, you subsequently asked us to review (1) the extent to which the Department's student aid data are effectively used to help ensure compliance with federal requirements and prevent any abuses from reoccurring, and (2) the improvements that the Department has planned or made to its student aid systems. Today you are releasing our report on the results of this study. My statement, which is based on the report, highlights the results of our work.[2]

Data used in our analyses were maintained in the Department's student loan and grant systems. Recognizing that the Department has had long-standing problems with how timely and accurate its student loan data are, we eliminated potentially erroneous data from our analysis. For example, we identified over 6,400 loan records that had date fields that were in error because (1) they contained zeros or (2) they contained dates that were before the time that FFELP started.

Results in Brief

In general, the Department has done a good job of providing grants and loans to eligible students, but it has been less effective in using available data to enforce compliance with federal requirements. For example, Department data indicate that 43,519 ineligible students may have received 58,105 loans, totaling over $138 million, for fiscal years 1982 through 1992, and that more than 48,000 students may have received overpayments of their Pell grants during the 5-year period ending in award year 1993. While our findings concern a small percentage of the total number of loans and grants in the Department's data systems, they indicate that the Federal Government can loose large sums of money through erroneous payments to students, some of whom are ineligible for any federal student aid.

The Department has initiated a series of improvements to its student loan and grant systems and programs. These include developing new systems, implementing data controls in existing systems, and strengthening program reviews at schools. These improvements are steps in the right direction, but some, corresponding with our review, have just recently been put in place and it is too early to determine their effectiveness. For example, new systems such as the National Student Loan Data System (NSLDS)—a national database on student loans and Pell grants—are just becoming fully operational. We also believe that some of the system controls in place, such as those to prevent students who had previously defaulted on loans from obtaining additional aid, are not sufficiently aimed at prevention.

In our report, we made recommendations to the Department to analyze student aid data more closely to identify patterns of noncompliance with federal requirements.

BACKGROUND

The Department of Education administers student financial aid programs under title IV of the Higher Education Act of 1965, as amended (HEA). During academic year 1993–94, student financial aid totaled $29 billion. The largest single source of this aid (72 percent) was FFELP,[3] which provided over $21 billion to 6.5 million borrowers. The second largest source of aid was the Pell Grant Program, which provided $5.6 billion in grants to 3.7 million students. During fiscal years 1983 to 1991, annual federal payments for FFELP loan defaults increased over 700 percent, from $445 million to $3.6 billion. Although FFELP loan defaults have decreased in the past 2 years, the Federal Government paid out over $2.4 billion in fiscal year 1994 to make good its guarantee on defaulted student loans.

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[1] *Student Financial Aid Programs: Pell Grant Program Abuse* (GAO/T-OSI-94-8, Oct. 27, 1993).

[2] *Student Financial Aid: Data Not Fully Utilized to Identify Inappropriately Awarded Loans and Grants* (GAO/HEHS-95-89, July 11, 1995).

[3] FFELP was formerly called the Guaranteed and Stafford Student Loan Programs.

Federal Family Education Loan Program

Most FFELP loans are based on financial need. A student typically applies for a loan, and the school verifies the student's eligibility. The school determines, based on family income and the estimated cost of attendance (COA), the amount of aid the student is eligible to receive. The student receives the loan from a participating lender. One of the state-designated guaranty agencies guarantees the loan against default. The agency is the intermediary between the Department and the lender, insuring the loan made by the lender to the student. The guaranty agency also ensures that the lenders and schools meet program requirements. The Department pays the interest due while the student is in school. The student begins repaying the loan, including interest and principal within 6 months after leaving school. The Department also reimburses guaranty agencies for most of the defaulted loans they paid to lenders and for some of their administrative costs.

Federal Pell Grant Program

Pell grants are distinguished from other financial aid in that students meeting federal eligibility criteria are given, not loaned, money. The Pell grant amount is also based on the student's COA and financial need. Schools, which make the grants on behalf of the Department, are to ensure that (1) each student meets federal eligibility requirements for the grant and (2) each eligible student is paid the full Pell grant that he or she is eligible to receive. During award years 1984 through 1994, Pell grants were awarded to over 32 million students, totaling over $50 billion.

Systems Used to Monitor FFELP and the Pell Grant Program

The Department annually collected loan data from guaranty agencies and consolidated them in the FFELP database.[4] These data, the principal data available for the Department to use in monitoring FFELP, were used to (1) calculate annual student loan default rates for schools participating in FFELP; (2) target program reviews of schools, lenders, and guaranty agencies; and (3) identify possible ineligible borrowers and loans exceeding statutory limits. But the usefulness of these data was limited because the data were not provided to the Department until after loans were awarded, sometimes as long as a year afterwards. The timeliness problem, however, is expected to be alleviated to a great extent when NSLDS is fully operational, if it is implemented properly. NSLDS is designed to provide on-line access to student loan data, which are to be updated monthly, not annually like the FFELP database.

As part of its monitoring of the Pell Grant Program, the Department collects student information from schools and consolidates it through the Pell Grant Recipient and Financial Management System (PGRFMS). This system is used to track schools' request for funds and provide schools documentation to use in reconciling their total disbursements to students under the Pell Grant Program during an award year, with the records of the individual students participating in the program at the school. Starting in the fall of 1995, NSLDS will also contain Pell grant data, which will be updated weekly.

DEPARTMENT DATA INDICATE STUDENT FINANCIAL AID INAPPROPRIATELY AWARDED

The Department's data show that ineligible students have received millions of dollars in student financial aid, and some eligible students have received more aid than permitted under the law. Students are generally ineligible for additional aid after defaulting on earlier loans and are prohibited from receiving funds in excess of statutory limits or their COA. Further, students are prohibited from concurrently receiving Pell grants from two or more schools.

Ineligible Students May Have Obtained Aid and Defaulted on Subsequent Loans

We identified 43,519 students that the Department's data showed may have been ineligible for 58,105 loans. The loans totaled over $138 million. To identify these students, we used student loan data in the Department's FFELP database for fiscal years 1982 through 1993. As an example of what we found, one student defaulted on a loan in May 1992, making the student ineligible for subsequent loans. According to Department data, however, this student received five additional loans: one in February 1993, two in July 1993, and two in September 1993. In another example, a student defaulted on a loan in September 1986, thus making the student ineligible for subsequent loans. According to Department data, however, this student also received five additional loans: one in 1988, three in 1989, and one in 1990—4 years after defaulting on the first loan. Further, according to the data, as of Sep-

[4] As of November 1994, NSLDS replaced the FFELP database and the data in the FFELP database were used to populate NSLDS.

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tember 30, 1992, of the 43,519 students who were ineligible for additional loans, 20,210 defaulted on 23,298 loans subsequently made to them. The amount outstanding on the subsequent defaulted loans, including interest and principal, was over $56 million.

Through our analyses of both FFELP and PGRFMS data, we identified 101,327 students who previously defaulted on a student loan and were, therefore, ineligible for further federal student aid. Nevertheless, the data showed that they may have received 139,123 Pell grants totaling approximately $200 million. Of these ineligible students, 73,934 may have received one grant, 19,838 two grants, and over 7,555 three or more grants.

Students May Have Received Loans Greater Than Their Cost of Attendance

The Department's FFELP database showed that, since 1982, students have received loans that exceeded their COA. The average amount of the overpayment was about $1,200 and ranged from less than $100 to over $13,000; the overpayments totaled $2.4 million.

Information available to the Department for tracking student loans—the FFELP database—was not used to verify that students received financial aid equal to or less than their COA, even though a COA data field is available for use. A Department official said that schools determine students' COA and financial need at the beginning of the student aid application process and that the Department relies on schools to ensure compliance with federal requirements.

To identify cases in which aid awarded exceeded COA, the Department could collect and use COA data to stop these practices and collect funds that were inappropriately awarded. COA data are currently used by schools to determine the amount of aid a student is eligible for, and we found that some schools are reporting these data. Therefore, collecting and reporting these data to the Department should not be a major burden for schools.

Students May Have Concurrently Received Pell Grants From Two or More Schools

According to the Department's records, during award years 1989 and 1993, over 35,000 students may have received Pell grants while attending two or more schools for the same enrollment period. The Department's data showed that these students attended two or more schools and received grants during the same month and year. Since the inception of the program in 1973, students have been limited to receiving Pell grants from one school at a time, even if they concurrently attended multiple schools. Schools are responsible for ensuring that students do not concurrently receive Pell grants from more than one school.

Although the Department has data to identify students who may have received grants while concurrently attending two or more schools, it does not use them for this purpose. Department officials said the data may be misleading. For example, they said the Department does not know how many of the students we identified or in PGRFMS actually received Pell grants concurrently from two or more schools because PGRFMS only records a student's enrollment date, not the date the school disbursed the grant. However, we believe that the information available to the Department indicates that numerous instances of noncompliance may have occurred and that, therefore, the Department should investigate further.

Students May Have Received Pell Grants in Excess of Statutory Limits

The Department has a control in place to prevent Pell grant payments from exceeding the maximum statutory limit for students attending a single school.[5] Using Pell grant data for award years 1989 through 1993, we found no instance of a student receiving a Pell grant greater than the statutory limit. However, the data showed that 48,010 students attending two or more schools may have received multiple Pell grants that in total exceeded the statutory limits. For example, in award year 1993, one student received grant funds totaling $5,640. The statutory limit in 1993 was $2,400; therefore, the student received $3,240 over the limit.

For award years 1994 and 1995, the Department implemented a system check in PGRFMS designed to block any Pell grant awards that would result in an overpayment and, as a result, the second school should not receive funds for that student unless the first school reports a downward adjustment. Because this system check was recently developed, it was too soon for us to determine what effects it will have on preventing Pell grant overpayments.

[5] The maximum statutory limit is set by the program's authorizing legislation. The appropriation legislation, however, often lowers the maximum statutory limit to meet the government's overall goals for domestic discretionary spending. We used the maximum appropriated statutory limits to determine whether students received overpayments.

OVERSIGHT AND ACCOUNTABILITY IMPROVEMENTS MADE, BUT MORE NEEDS TO BE DONE

We found instances in which compliance responsibilities were divided and data were ineffectively shared between Office of Postsecondary Education (OPE) units in the Department. In April 1991, the Department and Office of Management and Budget (OMB) jointly reported on the results of their review of how the Department administers student financial aid programs and made a series of recommendations.[6] The Department subsequently reorganized OPE in 1992 and developed a series of initiatives designed to better oversee FFELP.

Although the Department has completed initiatives and has others underway, we continued to find instances of lapses in accountability in which compliance responsibilities were divided among OPE units. For example, at the time of our review there was no unit responsible for overseeing all aspects of the Pell Grant Program. Responsibilities for policy, accounting and financial management, as well as for program systems were divided among three OPE units that did not routinely share information with each other. According to a Department official, the office for Pell grant systems had difficulty obtaining information from the office responsible for the financial functions of the Pell Grant Program.

During our review, OPE reassigned personnel and began making other organizational improvements that address our concerns about the dispersion of responsibilities among units. For example, in January 1995, it consolidated the Pell Grant and Applicants Systems Divisions into the Application and Pell Processing Systems Division; in April 1995, it consolidated the Pell Grant and Campus-based Financial Management Divisions into the Institutional Financial Management Division. Although we have not thoroughly evaluated these recent changes, they appear to provide a better organizational framework for program oversight and accountability.

OTHER IMPROVEMENTS UNDER WAY

During the past 2 years, the Department began implementing a number of other initiatives to address problems in operating and overseeing of its student financial aid systems. We found, for example, that the Department has improved its (1) student aid systems, including developing new systems, such as NSLDS, and implementing changes to existing systems, and (2) gatekeeping efforts by expanding the criteria for scheduling institutional program reviews.

These improvements have addressed many problems in Department systems and controls. But as discussed in more detail in our report, the Department must continue to make enhancements to help ensure compliance with federal requirements and to eliminate situations such as these that we found.

Developing NSLDS

The Department is developing NSLDS to be the first national source of current loan and grant data on student financial aid participants. NSLDS, for example, is to provide the Department (1) on-line access to loan data on a loan-by-loan basis and (2) more detailed current information on each student with a FFELP loan. When fully implemented, NSLDS is expected to provide an integrated view of HEA programs and should help ensure that improved and more accurate information is available on student loans.

NSLDS is planned to be implemented in three phases. Phase I began in 1993 and included populating NSLDS with data submitted by guaranty agencies. It became operational in November 1994. As a result, annual guaranty agency submissions of FFELP data tapes to the FFELP database ceased, although NSLDS will be updated with monthly data submitted by guaranty agencies.

Phases II and III, which include providing a central source of financial aid information, are expected to begin by the summer of 1995. The system, for example, is expected to provide financial aid transcripts, which will include information such as whether a student is in default on a loan or owes a repayment on a grant because of a previous overpayment. According to a Department official, selected Pell grant data from PGRFMS will be entered into NSLDS during Phase II.

Department Efforts to Strengthen Existing Systems May Not Go Far Enough

To reduce the likelihood that loans will be made to students who are ineligible because they had previously defaulted on their student loans, the Department has strengthened controls in its student financial aid systems. These changes include computer matches to identify students who defaulted and edits to identify Pell grant overpayments.

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[6] *Administration Adopts Plan to Reorganize Student Financial Assistance Programs*, U.S. Department of Education and the Office of Management and Budget (Washington, D.C.: 1991).

In July 1992, in response to an Office of Inspector General (OIG) recommendation, the Department expanded its computer matching. Through the Guaranty Agency Default Match, student aid applicant records are matched with guaranty agency files containing the names of students who defaulted on student loans held by guaranty agencies. OIG concluded that preventing ineligible students from receiving FFELP loans or Pell grants—abuses that the two computer matches were designed to prevent—should reduce program costs $300 million annually.

The computer matches have not been fully effective. From our analyses of data in the FFELP database, ineligible students appeared to continue to receive loans after the data matches were implemented. Specifically, the number of loans made to ineligible students increased from 10,450 in fiscal year 1990 (which was before the computer matches began) to 12,134 in fiscal year 1993 (after both matches were implemented). The amount guaranteed on these loans also increased, from about $24 million in fiscal year 1990 to over $33 million in fiscal year 1993. For fiscal years 1989 through 1993, the number and amount of loans made to ineligible students increased each year, despite the implementation of the data matches.

We discussed these findings with OIG officials. They were concerned that the matches were not preventing subsequent loans from being made to ineligible students. They have agreed to determine whether (1) the data matches were failing to identify subsequent loans to ineligible students and (2) ineligible students actually received the monies.

Expanded Program Review Efforts

The Institutional Participation and Oversight Service (IPOS), the OPE unit responsible for monitoring schools and ensuring their eligibility to participate in HEA programs, conducts on-site reviews at schools to determine if they are meeting program requirements. These program reviews are principally used to (1) identify violations and abuse after they occur and (2) target and conduct subsequent reviews.

OPE has revised its strategy for targeting IPOS program reviews by focusing on schools that had (1) significant increases in loan and grant volume and (2) high default rates for student loans. In part as a result of the Permanent Subcommittee on Investigations' October 1993 hearing and recommendations in a 1993 OIG audit report,[7] IPOS revised and expanded its criteria for selecting schools for program reviews. For fiscal year 1993 program reviews, the Department had 8 criteria for identifying schools for review. The number of criteria increased to 25 beginning in fiscal year 1994.

In addition, IPOS and OIG have begun to coordinate their review efforts to work better together and to help prevent simultaneous, uncoordinated, and multiple visits to schools. For example, beginning in the spring of 1995, IPOS and OIG began meeting monthly to discuss on-going OIG work and what effect it may have on IPOS reviews.

Because most of these initiatives were recently implemented, it was too soon for us to determine what effect they may have on improving compliance with federal requirements for the Department's student financial aid programs.

CONCLUSIONS

According to data in the Department's FFELP and the Pell Grant Program data systems, the vast majority of student financial aid was awarded in accordance with federal requirements. But in some instances these systems failed to ensure compliance with federal requirements in awarding student loans or Pell grants—conditions that have been long standing and that are likely to continue unless changes are made and effectively implemented.

We recognize that the Department relies extensively on schools to provide aid to eligible students in accordance with federal requirements. But the Department must improve its use of its data to support schools in their compliance assurance role and to evaluate schools' effectiveness.

Over the past several years, the Department has strengthened program controls, interoffice communications, oversight, and the systems used in administering its student financial aid programs. We commend these efforts and believe that they show a clear commitment by the Department to improve its management of the programs. But weak areas still exist. For example, data matches have not been fully effective in preventing ineligible students from getting additional aid and some Department systems, such as NSLDS, as currently being implemented will only identify ineligible students and will not be used to prevent them from receiving aid.

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[7] *Report on the Effectiveness of the Regional Institutional Review Branches' Monitoring of Institutions Participating in the Student Financial Assistance Programs*, Audit Control Number 05–20075, U.S. Department of Education (Washington, D.C.: 1993).

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Many of the problems that we identified have been long-standing and are likely to continue unless the Department takes further action. In our report, we made recommendations to the Secretary to take actions to improve the accuracy and completeness of student aid data, such as continuing to screen data entered into NSLDS to ensure that they are in a consistent format, and testing the accuracy and validity of data in NSLDS.

Mr. Chairman, this concludes my testimony. I will be happy to answer any questions that you or members of the Subcommittee may have.

APPENDIX I

RELATED GAO PRODUCTS

Student Financial Aid: Data Not Fully Utilized to Identify Inappropriately Awarded Loans and Grants (GAO/HEHS–95–89, July 11, 1995).

High Risk Series: Student Financial Aid Programs (GAO/HR–95–10, Feb. 95).

Financial Audit: Federal Family Education Loan Program's Financial Statements for Fiscal Years 1993 and 1992 (GAO/AIMD–94–131, June 30, 1994).

Student Loans: Millions Loaned Inappropriately to U.S. Nationals at Foreign Medical Schools (GAO/HEHS–94–28, Jan. 21, 1994).

Student Financial Aid Programs: Pell Grant Program Abuse (GAO/T-OSI–94–8, Oct. 27, 1993).

Financial Management: Education's Student Loan Program Controls Over Lenders Need Improvement (GAO/AIMD–93–33, Sept. 9, 1993).

Direct Student Loans: The Department of Education's Implementation of Direct Lending (GAO/HRD–93–26, June 10, 1993).

Financial Audit: Guaranteed Student Loan Program's Internal Controls and Structure Need Improvement (GAO/AFMD–93–20, Mar. 16, 1993).

Department of Education: Long-Standing Management Problems Hamper Reforms (GAO/HRD–93–47, May 28, 1993).

Department of Education: Management Commitment Needed to Improve Information Resources Management (GAO/IMTEC–92–17, Apr. 20, 1992).

Student Loans: Direct Loans Could Save Billions in First 5 Years With Proper Implementation (GAO/HRD–93–27, Nov. 25, 1992).

Stafford Student Loans: Millions of Dollars Awarded to Ineligible Borrowers (GAO/IMTEC–91–7, Dec. 12, 1990.)

BART GORDON
6TH DISTRICT, TENNESSEE
COMMERCE COMMITTEE
SCIENCE COMMITTEE
[illegible]

Senate Permanent Subcommittee on Investigations
EXHIBIT # 1

Congress of the United States
House of Representatives

Statement of Congressman Bart Gordon
submitted to the Permanent Subcommittee on Investigations
Committee on Governmental Affairs
July 11, 1995

Mr. Chairman, I want to thank you and the committee for allowing me to submit a statement to what I consider a very important hearing of the Permanent Subcommittee on Investigations.

As you may know, for several years reform of federal student loan and grant programs has been one of the top priorities of my service in Congress.

My strong interest in this issue began when I was approached by parents in my district who complained that the cost of college combined with the difficulty in receiving financial assistance meant that their children were putting off college for a year or two -- or sometimes forever.

I decided to take a hard look at exactly where the billions of tax dollars for federal student grants and loans were going.

I found two serious problems, fraud and abuse in loan and grant programs as well as an explosion of defaults in taxpayer backed loans. As members of this committee know, in 1980, about ten percent of the new funds appropriated for loan programs went to pay-off bad or defaulted loans, but by 1990 fifty-four percent of those funds were going to cover defaulted student loans -- and not available to other worthy students.

My investigation of Pell grant abuse and outrageous default rates led me to the source of much of the problem, unscrupulous proprietary schools which were not in business to educate students but instead to use students to get access to federal dollars.

The bad apples have been very bad for federal student financial assistance programs, and for that reason I committed to those parents in my district to do all I could to address these issues.

For the record, I will also submit to the committee a videotape of the NBC news program, Expose which includes my own undercover visit to one Tennessee proprietary school and gives an accurate overview of how problem schools have wasted precious funds in both the Pell grant and student loan programs.

After two years of a very hard fight, we enacted real reform and this committee under the exceptionally strong leadership of Sen. Nunn was key to that success. The very good news is that

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default rates are decreasing. Unfortunately, the fact that today's hearing is necessary indicates that we have a long way to go before we can honestly say we have done enough to protect students and taxpayers.

I am sorry to report that today's hearing is more about what we failed to do a few years ago when we passed a series of hard-hitting reforms aimed at cleaning up federal higher education financial aid programs.

One important amendment was removed from the final conference report during the higher education reauthorization process.

The loan cutoff for high default schools survived the conference and became the law of the land. Schools with 50 or even 60 percent default rates are no longer sucking up taxpayer backed loan dollars and leaving students high and dry with nothing but debts they can't pay.

But because an important provision was removed in conference many of these same schools have continued to receive Pell grants.

Think about what that means: if we don't trust these schools to handle loan dollars responsibly, does it make sense to allow them to receive millions of dollars in grants, for which there is even less accountability than in the loan program. In fact, most schools in the Pell grant program are allowed to draw down federal tax dollars directly, opening the door for the kind of abuse that will be discussed here today.

In the last Congress, I sponsored legislation to remove schools that could not be trusted to handle taxpayer backed loans from the Pell grant program as well.

Some argued that my amendment would keep poor students from receiving an education. That is not the case. Under this type of reform, students who are eligible for Pell grants will go to schools where counseling, course completion and job placement are priorities, not afterthoughts.

Some community colleges and public vocational schools that charge low tuitions will have only a tiny percentage of their students receiving student loans. In such cases, a few defaulting students could cause the entire school to lose its student aid funding. But the Secretary of Education now can and should exempt schools from the default rate cutoff when a cutoff would be inequitable.

Pell grants should help students get an education, graduate and find jobs. There are an ample number of good schools, public, private, non-profit and for-profit proprietary that focus on doing just that, and tougher guidelines will only bring more students into their classrooms.

Mr. Chairman, my amendment would have saved $40 million in budget authority for fiscal year 1995, but just as importantly it would have saved thousands of students from being sucked into worthless programs. The story of one school which you will hear today should only serve to underscore this point and the importance of continuing reform.

Finally, I would like to address a broader issue closely related to the policy implications of today's hearing.

The Federal Direct Loan Program, currently in its first year, has been described by one Department of Education official as "a Pell grant with a promissory note." In many ways I believe that is an accurate description and is an important reason why I have opposed the proposal to fully implement direct lending without a careful test.

The model for the direct draw down of federal dollars in direct lending is very similar to the same system which has led to repeated cases of fraud and abuse in the Pell grant program. As many as 45 schools that have problems with their Pell grant operation now have been allowed to sign up for the direct government loan program. Also, FDLP currently has no means of measuring default rates for schools in the program, and understandably high default school are moving into direct lending as quickly as possible.

Direct lending has the potential to become a safe haven for the kind of operations you are investigating today, and I believe that issue is worthy of review by this capable and proven committee.

Senate Permanent Subcommittee on Investigations
EXHIBIT # 2

Montgomery County Government

July 28,1995

Senator William V. Roth
Chairman
Permanent Subcommittee on Investigations
Russell Senate Office Building
Room 193
Washington, DC 20510

RE: Hearing On Federal Student Grant Program Abuses

Dear Senator Roth:

Over the last two years, the Montgomery County Office of Consumer Affairs has investigated several vocational schools. These investigations uncovered a wide range of deceptive trade practices being used by these schools in their efforts to attract students and the government money that comes along with them. The bait that is often used to attract students is the relatively "no strings attached" Pell Grant. Vocational school scams have historically been a problem. However, attempted reforms have been piecemeal at best. I am urging the Subcommittee to use these Hearings as an opportunity to fully examine the factors that create an environment in which fraudulent schools and well meaning, but ineffective schools, thrive at the expense of the taxpayer and to the detriment of those individuals who are attempting to improve their lives through vocational training.

Based on our investigation, it appears that the leading factor in this environment is the disconnect between the school's training activities and the verifiable placement of students in jobs requiring the skills that are ostensibly being taught by the school. Eligibility of schools to receive Pell Grant monies and federally guaranteed student loans must be controlled by the product (jobs) it produces, not by a review of a school's training program or process of teaching. If the school is not producing job placements, it does not deserve to be receiving federal monies. Such performance reviews should be quite stringent and should occur quite often.

Office of Consumer Affairs
100 Maryland Avenue, Rockville, Maryland 20850, 301/217-7373, TDD # 301/217-2999, FAX # 301/217-7367

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Our investigation revealed that once students have been attracted by promises of "free" money, they are further duped by false promises of quality vocational training and job placement. They then, with the very best of intentions to improve their lives, apply for and receive student loans. The harm that is caused by an inadequately monitored Pell Grant program is not limited to the dollar amount of the grant. Rather it must also be measured by the financial obligations that are imposed upon deceived students as a result of their legal responsibility to repay loans, as well as the detrimental effect these financial obligations have on any future opportunities to access the job market.

Ironically, the promises of training and employment are not only unfulfilled promises but result in an experience that severely limits the potential of many student to succeed in their chosen job path. Several of the vocational schools we investigated have closed abruptly, leaving students without recourse against the school and saddling the students with large loans. The majority of complaints involve students claiming that the school made promises of high tech education, guaranteed employment, and high salaries.

In the case of one such school, we have received complaints not only from the students who were in attendance at the time the school closed, and who may be helped by the new federal regulations covering closed schools, but also from students who attended several years ago. The allegations from both groups were the same, making it clear that the school was deceiving students for years. The students who attended in the past and feel they received nothing from their time at the school are now being faced with the federal government collecting their tax refunds and placing a negative report on their credit rating. They are having difficulty renting apartments or getting credit for car loans; bare necessitates for staying in the work force and maintaining their independence. The school that received the money from the federal grant and loan programs is the only party benefitting from the student's attendance. The losing parties are the taxpayers and the students.

In another case, a vocational school received large amounts of federal money by systematically soliciting students who were very low-income and oftentimes unemployed. This school was almost exclusively funded by Pell Grants and federally guaranteed student loans. The deception visited upon these individuals started with the very first solicitation they received from the school. The marketing pitch was such that they did not know it was a vocational school. They were told it was a job training program and that they would "earn while [they] learned".

In addition, they received promises of "free money", and promises of employment, via the school's "96% Placement Rate". However, it was found that only 6% of the students graduated and of these graduates those with jobs had either obtained the job on their own or the skills needed for the job had no relation to the computer skills allegedly taught by the school. Once again, the students who attended this school are faced with large student loans. Because of their unemployment and lack of skills these loans will probably remain unpaid, leaving the student with marred credit and no chance of attending a legitimate school.

These are just two examples of schools that abused the Pell Grant and federally guaranteed student loan programs. The primary goal of these schools was to access federal money, not to provide meaningful vocational training and job placement. In light of the current workforce's need for skilled workers and the desire of individuals to obtain training and a decent job, this is completely unacceptable and a blatant miscarriage of the public purpose upon which the Pell Grant and federally guaranteed student loan programs are premised.

By creating and enforcing a link between continued receipt of such monies and job placements, this Subcommittee will have gone a very long way toward alleviating the practices being discussed during this Hearing and uncovered in our investigation of a selected number of vocational schools. Anything short of mandating such a definite and measurable link would seem to be a continuation of the piecemeal reform efforts that have been attempted so many times before.

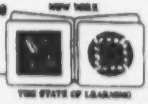
I appreciate the opportunity to provide you with the insight our Office has obtained and would also appreciate your including this testimony in the permanent record for the Hearing into the abuses in federal student grant programs, Part II. If you have any questions, or if we may be of any assistance to you and your staff, please feel free to contact either Mr. Joe Giloley, Administrator at 301/217-7394 or Ms. Sue Rogan, Investigator, at 301/217-7391.

Sincerely,

Barbara B. Gregg
Director

h:\general\roth.jtg

Senate Permanent Subcommittee on Investigations
EXHIBIT # 3



THE STATE EDUCATION DEPARTMENT / THE UNIVERSITY OF THE STATE OF NEW YORK / ALBANY, N.Y. 12230

DEPUTY COMMISSIONER FOR HIGHER EDUCATION AND THE PROFESSIONS

July 18, 1995

The Honorable Sam Nunn
U.S. Senate
303 Senator Dirksen Office Building
Washington, D.C. 20510

Dear Senator Nunn:

On behalf of the New York State Education Department, I thank you and your staff for your efforts to combat fraud and abuse in Federal student financial aid programs. We have followed over the years the hearings on waste, fraud and abuse of student financial aid by the Senate Permanent Subcommittee on Investigations and are aware of the commitment of time and energy which has been made.

As New York's State Postsecondary Review Entity (SPRE), we are acutely aware of the need to maintain a strong Federal/State partnership to thwart those postsecondary institutions that would abuse Federal student aid programs which represents 75 percent of all student aid in the nation. We believe that the postsecondary community efforts to eliminate SPRE if successful at this time would send the wrong message, lead to a loss of accountability and would be especially unfortunate in its timing -- discontinuing a well-conceived process which is on the verge of showing results. (Please see the attached rationale for preserving the SPRE program.)

As a significant component of the oversight of student financial aid, the SPRE program is a critical element in the triad defined in Title IV Part H of the 1992 Amendments to the Higher Education Act, which was designed to assure appropriate use of the nation's huge investment in higher education. We urge that you use your leadership and long hearing record to assure accountability through the SPRE program.

Sincerely,

Donald J. Nolan

Donald J. Nolan

Attachment

SPRE
(State Postsecondary Review Entities)

REASON CONGRESS AUTHORIZED STATE/FEDERAL PARTNERSHIP THROUGH SPRE AND WHY IT MUST CONTINUE

1. Federal government spends approximately $30 billion annually on student financial assistance (Pell grants and student loans), which represents 75% of all such aid in the nation. Congressional hearings in 1990 uncovered widespread waste, fraud, and abuse in the use of HEA Title IV funds for student assistance that was enriching some school owners and institutions at the expense of needy students and the taxpayers.

2. Bipartisan Congressional effort to correct abuses resulted in 1992 amendments to the Higher Education Act creating Federal/State partnership--SPRE (Part H, Subpart 1)--to monitor use of student assistance funds and eliminate waste, fraud, and abuse.

3. Under the SPRE program, only institutions with high student-loan default rates, Pell grant abuses, or heavy reliance on Federal student aid funds, or those that are suspected of fraud are referred by the U.S. Secretary of Education to a State Postsecondary Review Entity (SPRE) for further examination. (In New York State, for example, the Governor designated the State Education Department as New York's SPRE.)

4. Congress appropriated funds in 1993 and 1994 for SPRE's to initiate state planning for conducting SPRE reviews when requested by the U.S. Secretary of Education. (Standards were developed by each designated state entity in consultation with the colleges and schools in that state, and SPRE staff were selected and trained in those states.)

5. In spring 1995, New York and 6 other states with SPRE plans acceptable to USDE initiated SPRE reviews at 147 institutions identified by the U.S. Secretary of Education for their unusual patterns of using HEA Title IV student assistance funds (a small percentage of the institutions in those states):

   - 61% are proprietary (for-profit) institutions
   - 28% are private (not-for-profit) institutions
   - 11% are public institutions

6. Some Washington-based higher education associations have mounted an attack on this model Federal/State partnership, claiming it represents excessive governmental intrusion. However

   - Institutions do not have to accept the $30 billion in taxpayers' money if they are unwilling to be accountable to the public for its use.

   - Only institutions showing unusual patterns of use are referred to their state entity for further examination; the vast majority of institutions are not affected.

   - SPRE law does not require colleges and universities to produce any information that is not already required by other Federal statutes.

7. Some critics have confused USDE's recertification of institutions eligible to receive Title IV funds with the SPRE program, claiming that SPRE will require all institutions to be reviewed. This is not correct. USDE periodically recertifies all institutions; SPRE reviews are conducted at only the small percentage of certified institutions that show unusual patterns of using Title IV funds.

8. SPRE has barely gotten off the ground. This bipartisan creation must not be killed. Who will protect the taxpayers' $30 billion? Not the Federal government alone, which has no mechanism for conducting such reviews effectively. And certainly not the private, accrediting associations, which are themselves the creations of the institutions now receiving the $30 billion!

9. Congress should appropriate $20 million in FY 96 for its SPRE program to get off the ground. This will be one of the most cost-effective steps of the new Congress -- protecting $30 billion at a cost of less than one-tenth of one percent of that amount.

10. As the SPRE program succeeds and shoddy institutions shut down, accountability will increase and the need for SPRE reviews will decline. As a result, the cost of SPRE will become an even smaller fraction of the billions being protected.

OBJECTIVE

That the State Postsecondary Review Program authorized by the 1992 amendments to the Higher Education Act, Title IV, Part H, Subpart 1, shall receive an appropriation of $20 million for Fiscal Year 1996.

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92-498 96 - 6

Senate Permanent Subcommittee on Investigations

EXHIBIT # 4

URGENT CONFIDENTIAL MEMORANDUM

THIS DOCUMENT IS TO SHARED WITH NO ONE OTHER THAN THOSE TO WHOM IT IS ADDRESSED AND HAS NOT BEEN PRESERVED ON EITHER FLOPPY OR HARD DRIVE

DATE: 7/14/94

TO: Abraham, Sergio, Bernardo, Alex, and Gonzalo

SUBJECT: Current Refunds

As you are each aware during the period between July 1, 1993 and June 30, 1994, because of IADE's tax liens and other financial constraints, IADE paid only a very small percentage of the refunds actually due the Pell Grant program during this period. The actual amount paid in refunds during this period was only $284,866 for the entire award year.

As you are also aware, during this same period between 7/1/93 and 6/30/94 in order to increase cash flow we eliminated a number of checks and balances which allowed checks to print which would not normally have printed and/or been deposited into IADE's general fund. During this period for example:

a. students were transmitted to RGM's system and checks were printed based on "scheduled" rather than "actual" starts. Under the prior policy, we waited all five days after the student had been enrolled to transmit data and print checks;

b. in some instances student data was transmitted and checks were printed based on estimated income and tax data rather than actual tax returns data. Under the prior policy data was not transmitted and checks were not printed until after the tax return, if filed, was actually received; and

c. Pell checks were printed even before it was confirmed that ESAR's had been signed by the student or other required signature were obtained. Under the prior policy we confirmed that ESAR's were signed prior to the check being deposited.

Relaxing previously existing procedures allowed IADE to significantly increase cash flow in the short run. However, in the long run, the changes dramatically increase the amount of refunds due. For example, many of the students for whom we printed and deposited checks, should never have received any Pell funds at all. Consequently, as soon as the drop information is posted for these students, we will be forced to pay back ALL of the money we received for them. As I warned when IADE's senior management first decided to do this, the long term implications for refunds owed has been dramatic.

1. As of June 30, 1994 the total amount actually "appearing" as due in refunds is $1,078,496.

2. There are $364,166.00 in additional refunds which were posted to the system as paid on March 8, 1994 when Barry Glasser was conducting the most recent biennial audit but which in fact have never been deposited. RGM has repeatedly asked us to provide the deposit slips on these refund checks and reviews our bank statements on a monthly basis to determine if the checks have cleared. It should be noted that the checks for these refunds were drawn on banks with which we no longer do business. It is currently impossible for us to deposit these checks into the Federal funds account. Given the tone of recent calls from RGM, I expect it will be only a matter of a few more days RGM, in order to protect its own credibility with the Department of Education, will delete these refunds from the system. This will increase the Refunds Due "appearing" on the system to $1,442,644.

3. In addition to those refunds appearing on the system, there are approximately 1,607 students who are no-shows, withdrawals, terminations, etc. who have not been posted to the RGM system as no longer enrolled. Approximately 75% of IADE's student's who drop trigger refunds. In turn, the average refund for due for each student for whom a refund is triggered is approximately $859. As such, these students when posted will create approximately $1,035,310 in additional refunds, i.e., 1,607 x .75 x 859 = 1,035,310.

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4. The total projected amount of refunds actually due as of June 30, 1994, which includes both posted and non-posted refunds, is $2,477,974.

5. The annual projected amount of refunds due for the month of July 1994 and for each month thereafter, assuming we return to the prior check printing safeguards (see a, b and c above), will be approximately $140,000 per month.

6. These refund totals until paid will also create excess cash on hand in the exact same amount as the refunds due. It should be noted that unpaid refunds and excess cash on hand are the two most common reasons for the Department to place schools on reimbursement. If the Department were to take such action on these grounds it would be almost impossible for us to get it lifted even if we sued.

Having summarized the problem, I would propose the following potential solutions:

A. Only available solution is to pay refunds. Real issue is how. The previously posted $1,978,498 is the most immediate priority since these amounts are currently showing as due and will affect our excess cash on hand until it is fully paid and which would be very easy to spot in a review or audit. Assuming available funds, I would suggest the following:

i. post $900,000 in refunds paid at the end of July 1994 and actually deposit $450,000 at that amount at that time;

ii. deposit the additional $450,000 the second week August 1994 and, during the last week in August, post the remaining $178,498 in refunds as paid to the system and actually deposit the checks at that time;

iii. also during the last week in August, re-post as paid and actually deposit the $364,166 which shows as previously paid but was never deposited on 8/31/94 so it clears in September. It should be noted, however, that should ROM as predicted delete the prior postings which show these funds as paid, we would need to pay it sooner since the implications for excess cash on hand would be significant;

iv. by September 1, 1994 approximately $280,000 in additional refunds due should have accrued. While the appearance of these refunds can be delayed until then, delaying posting much longer will leave us with the same problem we currently face. My advice therefor is that if financially possible these refunds also be paid by the end of September 1994.

v. during the six month period between 10/1/94 and 3/31/95 we should post one-sixth (1/6) of the drops 1,607 drops which have not yet been posted and paying any associated refunds. This should work out to an additional 268 drops showing up per month and should add about $172,552 per month in refunds during the period between 10/1/94 and 3/31/95. Added to projected refunds of about $140,000 per month, total refund payments during this month would total about $312,552.

According to the proposed payment schedule the monthly refund payments (not postings, but actual deposits) would be as follows: (The number is the month)

7 = $450,000	8 = $628,498	9 = $644,166	10 = $312,552	11 = $312,552	12 = $312,552
1 = $312,552	2 = $312,552	3 = $312,552	4 = $140,000	5 = $140,000	6 = $140,000

Larger payment are deliberately scheduled earlier in the award year both because of the urgency of getting these paid but also because cash flow is greatest between July and September, reduces somewhat between October and March, and then declines significantly between April and June.

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It should be noted that it may be possible to move some of these payments and postings back by as much as two to four weeks. However, the greater the delay the greater risk we run in terms of audits, excess cash, reimbursement and/or having our aid eligibility and/or license to operate terminated. **Perhaps as significantly, because RGM is also required to undergo Federal audits, RGM has threatened that it might be forced to eliminate IADE's ability to post its own refunds. If this were to happen, we would actually have to provide deposits slips to RGM for each refund made and wait until they had the opportunity to post the refund as paid before it would show on the system. This would totally eliminate our ability to post refunds as paid before they really were. The implications for our ability to quickly "fix" things during an audit are obvious.**

As an IMPORTANT aside, in order to prevent the appearance of excess cash on hand, it is also very important that IADE not draw down large amounts of Pell funds more than about five days from the end of each month and that we deliberately request cash which is LESS than the checks we have printed for the month. The amount we UNDER REQUEST should be the amount appearing on the refunds due report. For example if the refunds due report at the end of July 1994 indicated that $178,498 was due in refunds, we should REDUCE the amount of our cash request for the month of July by at least that amount. Reports can be generated which will give us a more accurate indication of by how much we should under request funds. The amount of the under request however could be obtained at the start of the following month.

Potential Result If Not Corrected:

IADE will be required to undergo what are now annually required student aid audits and will, as we have already been admonished by the Nunn Committee, will be required to provide AUDITED FINANCIAL statements. These audits coupled with the audited financial statements will, given the auditor's familiarity with the RGM system, reveal the unpaid refunds. Even if we retained an auditor unfamiliar with RGM, the refunds would either be discovered during the file review or would be discovered when the auditor, as required by Federal law, met with RGM. In fact, all an auditor would have to do at this point to discover the unpaid refunds would be to look at our bank statements for the period between 7/1/93 and 6/30/94. The statement would show no refund deposits except for $284,866 for the entire award year. They would show only Federal Funds transfers. Given the prior response of the US Department of Education and ACCET's prior concerns regarding our past refund problems. They would almost certainly move to revoke aid eligibility and accreditation if it were discovered that we had failed to pay refunds after convincing them that we had solved our prior problems. Frankly, even once the refunds are paid, they are already late. As such, the longer we wait to pay the refunds the greater the risk to IADE. Our biggest dilemma is that though we could once again relax check printing procedures to generate more income in order to pay the 93-94 refunds, this would only create more refunds next year and make the problem worse assuming we could hide it for another year which, frankly, we can't. Frankly, in light of the Nunn investigation, if they discovered and could prove that IADE had deliberately hidden refunds and provided false information to Congress, IADE's senior management could face criminal prosecution. I say this not to scare you, but to point out as I have before that we have to fix this problem before it is discovered by some outside agency.

3

ORIGINAL

Senate Permanent Subcommittee on Investigations
EXHIBIT # 5c 1

mc

TRANSCRIPT OF VIDEOTAPE

HEARING ON ABUSES IN FEDERAL STUDENT GRANT PROGRAMS

- - -

WEDNESDAY, JULY 12, 1995

United States Senate,

Permanent Subcommittee on Investigations,

Committee on Governmental Affairs,

Washington, D.C.

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507 C Street, N.E.
Washington, D.C. 20002
(202) 546-6666

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Mr. Gelber. Look at that paragraph, please. It says, "Also during the last week in August, Ripost has paid"--

Mr. Williams. Right.

Mr. Gelber. --"and actually deposited the $364,000."

Mr. Williams. Right, meaning that it had not previously actually been deposited.

Mr. Gelber. I mean, let's be straight here. On July 14th of '94, you didn't need one more drop of information to know what was going on, because just the fact that they weren't--they weren't depositing things they were posting tells you these guys were attempting to defraud anybody who would be looking at the accounting of IADE. Now--

Mr. Williams. My comment at the time--my comment at the time was that as--I used to be a program reviewer, and my comment was I believe that the current evidence would provide substantial indication of not only improper practices but an intent to defraud, and the quicker you fix it, the better off you are.

Mr. Gelber. I guess my question to you is: At the time you wrote this, sir, you knew they were committing--you believed they were committing a crime?

Mr. Williams. I--

Mr. Gelber. Think about it.

Mr. Williams. I'll answer it honestly. At the time--I have to answer it honestly, anyway. I'm under oath.

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Mr. Gelber. That's the--

Mr. Williams. At the time, I was relatively--I'd be a moron and I wouldn't be a nationally known aid administrator if I didn't know that they were committing--or were almost certain that at least one or more of the owners was committing a crime. The fact of the matter is, though, knowing that, I deliberately chose not--even though I implied or indicated that there were problems, I deliberately avoided asking any question that would give me an absolute answer that fraud had occurred. Because if that had happened, I would have been required--and I would have--I would have been required to notify the department directly. And I probably would have done it anonymously, but if I had--I chose to remain ignorant deliberately.

Mr. Gelber. Mr. Williams, you would agree with me that by putting--by posting refunds that were not deposited, by creating a false trail, an intentionally false trail--it doesn't really matter whether it's Congress or State or Federal educational oversight groups--people are going to be looking, and the purpose of all this effort was to defraud, to mislead, all those State and Federal agencies, whether it's the Senate, whether it's the House, or whether it's the Department of Education or the State oversight.

Mr. Williams I believe that, in particular, Sergio's activities as relates to failing to deposit checks would had

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been posted to the system, in terms of ESARs that had-- checks that were not supposed to have been deposited that suddenly ended up being deposited, that, yes, in fact, that intent was to defraud. That is very clear.

Mr. Gelber. Now--

Mr. Williams. If it were not for my ability to have gotten them off the first time or the subsequent time, they would have ended up closing.

Mr. Gelber. We're not going to go on to what the Stofenmachers made in this institution or how--

Mr. Williams. Oh, absolute--I--judging by some of the information that we've gotten after the fact, very clearly the Stofenmachers greatly abused, greatly abused. The salaries were ridiculous, the car payments, the cellular phones, the dinners. Mark and I have discussed all of those. Absolutely.

Mr. Gelber. This wasn't behind in refunds anymore. This was presenting false statements, false notices, false information to a third party or, in fact, from your own institution to an arm of the Federal Government, to the Department of Education, or to whomever was looking over IADE's shoulders. So I guess my question is: You testified a moment ago that you regret not going to criminal authorities and saying a crime is--

Mr. Williams. I also regret not bringing it to the

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attention of the department. In effect--and in hindsight, in effect, my delay in both resigning and my failure to bring it to the attention of the department, in effect, ended up still costing the same number of students enrollment, still cost IADE's employees their jobs, and at the same time, because of the delay, cost the Federal Government additional funds which may or may not ever be recovered. And for that, I regret.

Mr. Webster. Were any of the campus financial aid directors instructed not to post attendance or grade information?

Mr. Williams. During the period that Sergio had indicated--during the period that Sergio was not writing checks and not authorizing checks to be printed, the--at one--I think we discussed this before. At one point when they were briefly behind on refunds--and I don't remember the date, but we had informed the campuses--we had informed the campuses that you might as well catch up on your other work, there is no reason to post refunds because Sergio's not authorizing any payments to be made.

- - -

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Senate Permanent Subcommittee on Investigations
EXHIBIT # 6

6-1-95

To: Mark Webster

From: Arnaldo Sanchez

I'm taking this opportunity to inform you that the day ACCET arrived at the Oxnard campus back in 1993, Sergio Stofenmarcher instructed me to go to the tool room in the automotive shop, where he have had someone connect the wires from the fax machine to be used as a regular telephone number, for the purpose of been answer when ACCET personal called and the persons that Sergio designated, was supposed to answer, in order to give the ACCET inspectors a good placement report of the student(s) that they were inquiring about, this particular students had never been placed by AIDE.

Senate Permanent Subcommittee on Investigations

EXHIBIT # 8

AFFIDAVIT
OF
JORGE E. SHEPPARD

JS SHEPHERD

My name is Jorge E. Sheppard. I live at 5738 Whitsett Avenue, Apartment 302, North Hollywood, California. I am originally from Peru and graduated from the University of Lima with a degree in business administration. I immigrated to the U.S. in 1988 and am now a legal resident.

On June 25, 1990, I applied for an Education Clerk position with IADE at the Southgate campus and was hired by Gus Guerra, the Director of Operations. My initial duties consisted of filing education records, but later that year they were expanded to include counseling students, taking care of education records, and signing counseling forms. In December 1990, I was transferred to the North Hollywood campus, where I served as the director until July 1992. This position was very stressful -- there weren't enough employees and I had to work 14-16 hours a day to make up for this deficiency -- and, as a result, Sergio Stofenmacher agreed to move me to the corporate headquarters, where I was given a job helping the Compliance Director, Luis Markes

Initially, I didn't do much in this position, since IADE was expecting a visit from the Accrediting Council for Continuing Education and Training (ACCET) and all that was being done was checking records to insure that the school was complying with ACCET regulations. However, in August 1992, I was put in charge of checking placement records and started calling the employers listed on them to verify the employment status of students who had completed a program of instruction at IADE. I found that many of the records at the Santa Ana campus were fraudulent, that is, when contacted, the employers said they never heard of the person who was listed as having been placed with them. I brought this matter to Sergio's attention and he terminated the responsible Santa Ana campus placement counselors.

In October 1992, IADE was placed on reimbursement by the Department of Education. I became familiar with this situation because I worked on preparing the reports required by the Department in order for IADE to continue to receive its student financial aid funds. I believe that IADE was placed on reimbursement because of complaints from Southgate campus students regarding constant changes in the instructors and the poor quality of the training provided. Indeed, reflecting these problems, during 1990 and 1991 the Southgate campus had a number of different directors. Sarah Echea, who was the director at the time I was hired, left in September or October 1990 because of her inability to do anything about the shortages of books and other course materials. Her replacement was Jacob Ocampo, who left in just a couple of months because he too was unable to resolve students' complaints. Next was Rodrigo Oleas, who also lasted just a few months, leaving suddenly in June 1991.

In March 1993, I became Director of the Audit Team, which consisted of six "auditors" (they were neither professional auditors nor did they necessarily have specific accounting background or experience), whose job was to insure that all education records complied with applicable regulations. In connection with this new responsibility, I asked Ken Williams, IADE's Financial Aid Director, to help me understand the school's financial

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aid record keeping procedures. After Ken provided this explanation, including showing me the computerized financial aid master sheets maintained on each student, I decided to reinforce what I had learned by printing out ten master sheets and comparing them with the corresponding education records. I discovered that some of the financial aid records didn't match with the education records as they should have, so I did another run, comparing 100 financial aid master sheets with the corresponding education records. In this case, I found about 20 that didn't match; and, specifically, that the master sheets in these instances showed students to have been enrolled much longer than what was shown on the education records.

I showed these discrepancies to Gus Guerra, who agreed that something appeared to be wrong and, after calling a meeting of all the department heads to discuss this situation, concluded that proper procedures were not being followed in posting records of students who had withdrawn or dropped out. The proper procedures were that when a student withdrew or dropped out, staff at the concerned campus should have recorded the last day of attendance, filled out a counseling form, and forwarded the latter to IADE corporate headquarters. At headquarters, the counseling form and the information on it should have been posted in the computer record-keeping system and, if necessary, should have been used to calculate any applicable refunds. The student's education records were also supposed to be sent to corporate headquarters, to be filed in a designated storage cabinet.

In April or May 1993, Gus told Sergio about this problem. Sergio became visibly nervous, but insisted that the figures on the master sheet were correct and that the problem was not with them but my failure to follow established procedures. I checked my department's procedures and, after finding that they had been properly followed, initiated an audit of the entire record-keeping process because I suspected that someone outside my department was changing information in the records, . This audit led to the data entry department, where Taimi Aleman and Maria McFarlane worked, and some of my suspicions began to be confirmed when I overheard Sergio and Taimi complaining that Alejandra Hull, the person responsible for collecting and filing the education records from the individual campuses, was not giving all the education drop files to Taimi to review. What struck me about this was that it simply didn't make sense, since it was the my department's job to audit the drop files for accuracy and, therefore, I could see no reason why Taimi would want to review them.

Soon thereafter, my suspicions were completely confirmed when, in connection with an impending audit by the California Council on Postsecondary and Vocational Education (CCPVE), I entered Taimi's office to look for some drop files and came upon boxes of education records that should have been filed in the cabinets designated for this purpose. Taimi, who had been on vacation when I entered her office, later told me that the records were there because she was checking the amount of Pell Grant refunds due and amending those records that weren't correct. I knew this was not true because I had seen all the files before Taimi got them and was specifically aware of many of the students' status and/or the related information on them. In examining these records, I found that Taimi had routinely changed them and the corresponding master sheet to reflect more credits than the students had

actually completed -- for example, the record would show that a student had completed 18 credits instead of the 10 initially listed. I also discovered that Taimi had fabricated tests to put in the student education files to make them appear more authentic. These actions by Taimi served two purposes: they helped lower IADE's refund obligation; and, they extended the student's enrollment status, which made the student eligible for an additional Pell Grant payment.

When I told Sergio about what I had found, he said he would correct the problems I'd identified. However, while he did make some changes, as I was reviewing some education files a short time later, I discovered that Taimi was still taking the records and altering the credits and attendance on the master sheet, after I had verified this information and placed the records in the designated file cabinets. Furthermore, when Sergio realized that the drop form filed at the individual campus could still be used to show the inconsistencies in the records altered at the corporate headquarters, he changed the procedure so that it would not be posted at the campus until after headquarters personnel had had a chance to alter it.

These problems and the failure to correct them were the focus of a July 1993 meeting attended by Sergio, Alex, and Bernardo Stofenmacher and Gonzalo Freixes (the General Counsel), where Augusto Pensajoff (IADE's Systems Director) and Gus went over this situation and said to those present that Sergio could not continue to have records changed because if he did, everyone could lose their jobs. (I was in an adjacent room and overheard the entire discussion.) Although the record changing activity stopped for a while after this meeting, in early 1994 I began to notice that education drop files were missing from time to time. When I looked into this further I once again found the same kind of thing happening as before; for example, I came upon an instance involving a student that reenrolled after having dropped out earlier, whose records showed changes that reflected more credits and a longer period of attendance than were actually completed. To the best of my knowledge, this kind of activity is still continuing.

I also have personal knowledge of the following:

-- Ken Williams is aware of the records-changing problems and at one point told Sergio that if it didn't stop, he was going to report it to the Department of Education.

-- BASA exists only to employ illegal aliens. Toward the end of November 1993, someone at IADE informed the U.S. Immigration and Naturalization Service (INS) about the illegal aliens working at BASA, prompting an INS investigation that has resulted in deportation proceedings against a number of them.

This is just a comment I hear from some other employees but I'm not sure J.S

I have read, reviewed, and initialed each page of this statement consisting of four pages, and I

affirm, to the best of my knowledge, belief, and recollection, that the statements contained herein are true and correct.

Jorge E. Shepard
SHEPHERD

Sworn to and subscribed before me this
24 day of DECEMBER, 1994.

Notary Public

My Commission expires:

11-11-95

OFFICIAL NOTARY SEAL
LUIS PEZZINI
Notary Public — California
LOS ANGELES COUNTY
My Comm. Expires NOV 11,1995

Senate Permanent Subcommittee on Investigations

EXHIBIT # 9

AFFIDAVIT
OF
AUGUSTO V. GUERRA

My name is Augusto (Gus) V. Guerra. I live at 325 N. Garfield Ave, Alhambra, California. I am originally from Lima, Peru, and immigrated to the United States on July 3, 1981 and was granted U. S. Citizenship in 1988. I began working for National Technical Schools (NTS) ~~soon after my arrival~~ ON APRIL 23, 1982.

I begin work for IADE on August 1, 1985. IADE is owned and operated by Abraham Stofenmacher and his three sons, Bernardo, Alejandro and Sergio Stofenmacher. Bernardo and Abraham initially wanted me to help them obtain accreditation from the National Association of Trade and Technical Schools (NATTS). I had experience along these lines from my work at NTS, but also sought the assistance of Robert Gonzales, owner of RGM Enterprises, whom I have known since 1982. (RGM was IADE's loan servicer and still maintains the school's student financial aid data.) The Stofenmachers initially didn't understand why they needed to be accredited. With help from Gonzales, I gradually explained to the Stofenmachers the need for and the benefits of accreditation and then started the process to obtain it.

When I started at IADE, it was a new school and the operation was very small. At the time, IADE's management consisted of Abraham, Alejandro, and Bernardo Stofenmacher and a son-in-law, Daniel Levy. While the school was small it was still difficult to get anything done because Abraham, Alejandro, and Bernardo collectively had to approve everything and disagreements among them were common. At one point in early 1987, Abraham simply told me to submit an application to NATTS, even though I warned him that much more information was required in order to be successful. Later, on May 5, 1987 NATTS conducted an accreditation site visit at IADE, for which IADE was obviously ill-prepared, and was thus turned down. NATTS provided a list of areas IADE needed to work on in order to qualify for accreditation, but IADE's September 1987 response to these recommendations was unacceptable and the school was never accredited by NATTS.

At about the same time, a close friend, Murray Cohen wanted to start USA Schools and asked me to come to work for him and help with the accreditation process. Because of the problems I had working with the Stofenmachers collectively approving everything, I resigned from IADE and began working for USA Schools in October 1987. This job, however, lasted for only about a year, in large part because of the stress I was undergoing as a result of marital problems. I ~~left~~ WAS TERMINATED FROM USA schools in October, 1988.

Shortly after I left USA Schools, Sergio called me unexpectedly and said he knew I had gone through some problems and could have my job at IADE back if I wanted it. I was interviewed by Abraham and Bernardo, who said that they wanted me to work on the administration of the rehabilitation students program and IADE's new accreditation package. I accepted the offer and started on October 23, 1988.

To begin the process of applying for accreditation, I read the Accrediting Council for

Continuing Education and Training (ACCET) requirements and attended some workshops conducted by Debbie DeVries, who at that time was an ACCET employee,. Over the next several months, I worked closely with Bernardo on the application package. ACCET approved the application and visited IADE in March 1989. Abraham, Bernardo, Alejandro, and Daniel Lory were present during this visit. On July 15, 1989 ACCET approved their accreditation and in August IADE submitted its accreditation/certification package to the U.S. Department of Education. We worked closely with Joe Summerville, a Branch Chief in the Department's Institutional Participation and Oversight Service division in Washington, D.C., during this process and in October, IADE was approved. The first class to participate in Title IV programs started on October 16, 1989.

In January 1990, I was promoted to the position of Director of Operations. Additionally, I contracted with the California Council for Postsecondary and Vocational Education to help them conduct reviews at other proprietary schools.

I first began to be concerned that things weren't right at IADE when, on several occasions in 1991-1992, instructors from the Santa Ana and Oxnard campuses asked me why some students in their classes couldn't read or write in English. I felt this was at least partially due to improper screening on the Wonderlic ability-to-benefit test and recalled that in 1991 a number of test administrators – e.g., Jaime Feinberg, Eduardo Victoria, and Pedro Velasco – were hired, who I felt weren't qualified to hold such a position. In 1992, through an audit by the Department of Education IG, I learned that IADE test administrators were using inappropriately low cut-off scores, thereby enabling unqualified students to enroll. The minimum acceptable score for the Wonderlic ability-to-benefit test was 15 for computer courses, 13 for automobile mechanic courses, but IADE was using a minimum passing score of 10 for all the tests. I asked Abraham Stofenmacher about this on at least three occasions in 1992. He told me that the ability-to-benefit regulations were being followed. After the IG audit, Abraham put out a memo specifying that the proper minimum passing scores were those set by Wonderlic.

In 1991 an instructor at the El Monte campus, Kevin Shaw, told me about an ESL student – Nuno (I don't remember his last name) – who wasn't able to read or write Spanish or English. Kevin asked me what to do about this, so I counseled Nuno and, despite his pleas to be allowed to remain in the class, removed him. Nuno told me that he had taken the ability-to-benefit test three times, had never passed it, but had begged to be admitted. The school director, Gladys Canovil, said that she went to Sergio and explained the situation to him and Sergio said to let him in. Nuno received Pell Grants while attending the ESL course. Mr Nuno was removed from IADE and was sent to an adult literacy program.

During ACCET's reaccreditation visit in May or June 1992, Maria McFarlane, who worked as a placement coordinator, told me that she observed student placement records being fabricated. As part of their reaccreditation process, the ACCET site team examined student placement records. The site team found from this examination that IADE's placement figures failed to meet either ACCET or California's 70% requirement and that the record keeping was inadequate. In response, Sergio asked Ken Williams, IADE's Financial Aid

* Daniel Lory, by the time of my second period of Employment at IADE he had already left & opened United Schools - EDUCORP

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Director, and me to look into this, but our examination of placement records showed IADE still failing to meet the 70% target by a wide margin; whereupon Sergio told us he'd take care of it. Maria McFarlane told me that about the same time as ACCET's reaccreditation visit she observed Sergio, assisted by Lilly Saavera (the Los Angeles Campus Placement Director), Taimi Aleman (a data entry clerk) ~~in Financial Aid~~), and Patricia Rivera (a records clerk), fabricating placement records so the numbers showed a 70% placement rate. Maria told me they did this, under Sergio's direction, by sending IADE employees to the Bankruptcy Court building to gather names of firms to use as places where school graduates were purportedly working.

I also discovered that there were problems with the records of students who dropped out of or withdrew from a course of study. I overheard Sergio say that many of the education records were not correct and that they showed the students having attended fewer classes and completing fewer education units than he (Sergio) claimed they did. Sergio assigned Taimi Aleman the job of auditing all the records of students who dropped or withdrew, something I didn't understand, since they had been previously audited by Jorge Sheppard, the Director of IADE's internal audit team. According to Jorge, Maria McFarlane told him that in 1992 Taimi routinely found records that she said should reflect more credits than they did -- for example, that a certain student completed 18 credits instead of the 10 shown on the record -- and then changed the master sheet accordingly. Additionally, Jorge discovered from examining some of these records that it appeared that Taimi fabricated tests to put in the student education files to make them appear more authentic.

Furthermore, when I compared an education file brought to my attention by Gabriel Ramirez (an IADE admissions representative) regarding a no-show (enrolled/never attended classes) to the RGM computer master sheet, the latter showed that this student received a Pell Grant disbursement. I double checked this with the computer record at the South Gate campus, which confirmed that the student never attended classes at IADE. After conferring with Jorge Sheppard and reviewing about 100 more student records covering a six-month period beginning in May 1993, we found that 20 didn't match with education records. Specifically, the master sheets in the student records in these instances showed students to have been enrolled much longer than what was listed in the education records. I approached Ken Williams about these problems late in 1993. He appeared to be upset that such activities were going on. However, when Sergio found out that Williams had been told, he became upset with me, blaming me for instigating trouble for IADE. Sergio walked into my office and starting yelling at me & Bernardo Stolarmacher of acting against IADE.

I have read, reviewed, and initialed each page of this statement consisting of five pages, and I affirm, to the best of my knowledge, belief, and recollection, that the statements contained herein are true and correct.

Augusto V. Guerra

Sworn to and subscribed before me this
21 day of December, 1994.

Notary Public

My Commission expires:
11-11-95

OFFICIAL NOTARY SEAL
LUIS PEZZINI
Notary Public — California
LOS ANGELES COUNTY
My Comm. Expires NOV 11, 1995

Senate Permanent Subcommittee on Investigations
EXHIBIT # 23

United States Senate

COMMITTEE ON
GOVERNMENTAL AFFAIRS
WASHINGTON, DC 20510-6250

June 20, 1995

Ms. Mary Gibbons, Esquire
727 West Seventh Street, Suite 929
Los Angeles, California 90017

Dear Ms. Gibbons:

This is to notify you of the change in the date of the Pell Grant hearing. The new date is July 12, 1995 at 9:30 a.m. This change was due to a conflict with other Committee Members' schedules.

Just in case you have not received Mr. Bernardo Stolenmacher's subpoena for testimony, enclosed please find another copy. Additionally, if possible, please advise on status of our latest document request.

Sincerely,

R. Mark Webster
Staff Investigator to the Minority
Permanent Subcommittee
on Investigations

Enclosure

RMW:mw
cc: Phillip A. Trevino, Esquire

Law Offices
MARY GIBBONS, ESQ.
84 Route 303, Suite 134
Tappan, New York 10983

(500) 348-6279

July 3, 1995

BY FACSIMILE TRANSMISSION

R. Mark Webster
Staff Investigator
Minority Subcommittee on Investigations
Committee on Governmental Affairs
United States Senate
Washington, D.C. 20510-6250

Dear Mr. Webster:

This letter will confirm our conversation regarding my acceptance, as counsel to IADE American Schools (herein "IADE"), the subpoena which your office has issued for the appearance of Bernardo Stofenmacher before the Senate Permanent Subcommittee on Investigations of the Committee on Governmental Affairs of the U.S. Senate, which was initially scheduled for June 1, 1995, but which has subsequently been continued to July 12, 1995. My acceptance of this subpoena in no way waives or abrogates any of Mr. Stofenmacher's rights in regard to such subpoena, rather it is solely for the purpose of avoiding the logistics of personal service.

Please be advised that, in light of the fact that the Federal Bureau of Investigation, together with the Office of the United States Attorney for the Central District of California, is conducting an investigation of IADE, Bernardo Stofenmacher, as an officer of the corporation, will invoke his Fifth Amendment privilege against self-incrimination if called to testify as to any matters concerning IADE or the activities of its officers and employees. In light of this fact, on behalf of Bernardo Stofenmacher, I am requesting that your office waive his appearance in order that he might not be required to travel from Los Angeles to Washington, D.C. simply to invoke the privilege to which I believe we agree he is entitled.

Should your office determine not to waive Mr. Stofenmacher's appearance, please be advised that I will appear with him at this hearing. You have apprised me that, pursuant to the "Rules of Procedure for Senate Permanent Subcommittee on Investigations of the Committee on Governmental Affairs As Adopted", dated February 16, 1995, specifically Rule 8 thereof, the Subcommittee Chairman is authorized to seek to preclude my appearance with Mr. Stofenmacher in light of my representation of IADE. It is my view that, should Mr. Stofenmacher be required to appear personally, he would be entitled to appear with counsel of his choosing, and that your office could not abrogate his Sixth Amendment right to counsel. In order to avoid an "eleventh-hour"

dispute over this issue, please advise me if your office will agree, should Mr Stofenmacher be required to appear, that you would not raise any objection to my appearing with him at this hearing. Should you intend to make such objection, I would hope that you will notify me in sufficient time to afford an opportunity to litigate the issue

Please note my new mailing address and telephone number above. In that I have just relocated, I do not yet have an established fax number, however should you need to transmit any materials to me, please call and I will arrange to receive it. Thank you very much for your consideration and co-operation.

Very truly yours,

Mary Gibbons

Senate Permanent Subcommittee
on Investigations
EXHIBIT # 27

March 2, 1995

Roger Williams, President
Accrediting Council for
Continuing Education & Training
600 East Main Street, Suite 1425
Richmond, Virginia 23219

Re: Issues raised in the February 3, 1995, ACCET team visit exit interview

Dear President Williams:

This correspondence serves as IADE American Schools' interim response to issues related to "no-show" students raised during the exit interview at the conclusion of the February 3, 1995 unannounced visit by representatives of the Commission. IADE American Schools fully understands and appreciates that normal Commission protocol dictates that the institution wait until the official review report has been issued prior to responding. However, given the seriousness of the matter in question and the apparent **"perception"** of the review team as relates to this issue, the institution felt a strong obligation to respond as quickly as possible to the Commission's concerns. As indicated, this response is solely directed to those aspects of this issue discussed by Commission representatives during the exit. As such, it is preluminary in nature and in no way should be viewed by the Commission as this institution's sole or final response to this or other issues which may be raised at such time as the actual team report may be issued. This being said, let us begin to address the specific nature of this response.

We expect to have completed within the next week or so a report entitled **"Interim Response and Corrective Action Plan to February 3, 1995 ACCET Team Visit"**. This report will document and explain an unusual set of circumstances during a portion of the 1993-94 Federal aid award year, which **inadvertently** resulted in a limited number of students who signed enrollment agreements but never began classes receiving Title IV funds. Specifically, the interim response will describe how an equally limited number of enrollment status reporting errors by academic records clerks within IADE's Office of Education unintentionally bypassed a series of institutional controls designed to prevent this type problem from occurring and how these same errors prevented the institution from determining that this problem had occurred until it was brought to our attention by the visiting team. In addition, the response will establish that:

a. immediately upon learning of the concern from the visiting team, IADE American Schools, without being directed to do so by the Commission or any other oversight agency, contracted with an outside CPA to perform an expedited, independent audit related to this issue. This audit has now been completed, we are surply waiting for the report to be issued before making full restitution of any resulting liabilities.

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b. as indicated in the preceding item, once the CPA submits his final audit report, IADE is prepared, again of its own volition and concern for the integrity of the Title IV aid programs, to make full and complete restitution to the U.S. Department of Education for the improperly expended funds. Based on preliminary indications from the auditor we expect the liability to be approximately $130,000. It should be noted that while this amount is not insignificant, it is less than one-tenth of one percent of the total Title IV aid funds received by the school for the period in question; and

c. despite the problem having been confined to the 1993-94 award year, the institution has implemented additional modifications to its existing procedures and training for academic records clerks and other Education Office staff to ensure that no such error occurs in the future.

This being said, there is one other important issue relating directly to the core concerns of the team members which the response will attempt to lay to rest. The report will establish that, despite a series of unfortunate circumstances which appears, based on the exit interview, to have lead the team to believe otherwise, IADE made every effort to comply fully with information requested by the members of the team during the visit. Specifically, the report will document how the unannounced nature of the visit, the relatively brief period of time spent on-site by the team (only a little over six hours), the school's computer system being down during most of the visit, the unavailability of several canceled checks which, as part of the institution's fiscal year close out, were at IADE's accountant's office on the day of the visit created, perhaps understandably, the impression in the minds of the team that IADE was being less than fully cooperative. This impression, which was both clearly evident and directly expressed by members of the team during the exit interview, seems to have been furthered by two additional factors. The first is the fact that, as the Commission is well aware from numerous prior visits to IADE, files and related records for inactive students are maintained at IADE's corporate office rather than at the school. Consequently, these documents, which represented the bulk of the documents requested by the team, had to be pulled from storage at the corporate office, sorted, boxed and delivered to the school.

A second concern seems to have resulted because of confusion regarding second-hand information provided over the phone from the corporate office to IADE's Director of Student Financial Assistance while he was on-site at the school for the team visit. That information, which was believed at the time to be fully accurate, was subsequently conveyed to members of the team. IADE was later to discover, however, that the information provided to the aid director, and subsequently to the team, had been based on an incorrect assumption by support staff at the corporate office who phoned the school with the information. Specifically, staff at the corporate

office phoned IADE personnel at the school indicating that five students for whom the team had requested student aid information were "not in the system" and therefore must be "non-aid" students. Though IADE personnel on-site for the visit, quite understandably, took this to mean that corporate support staff had actually searched student aid computer records and paper aid files for the five students, we subsequently learned that this was not the case. Instead, we discovered, much to our dismay, that staff had simply looked the students up on the education system computers (which do not directly interface with the student aid system), discovered that the five students were no-shows and, believing, we now know falsely, that such students could not have received aid, bothered to look no further. This same staff then reported the five students to on-site personnel as "non-aid". Though three of the five students were subsequently found to have received aid when the Corporate Aid Director, at the request of the team, ordered a complete records search of the automated student aid system, this was not discovered until a little after 6:00 pm on February 3, 1995, by which time the team had already departed.

Despite our concern that the team may have mis-perceived the nature and scope of the problem as well as IADE's willingness to assist in the review process, IADE in no way believes that the team acted improperly in the conduct of the visit. Frankly, had the situation been reversed and IADE personnel been the ones conducting the visit, I am not at all certain that, given the same series of unfortunate circumstances, we would have been nearly as tolerant as the members of the existing team. It is important to note, however, that the same factors which so frustrated the team during their inquiry, i.e., waiting for files from the corporate office, the school's automated student aid system being down, the relatively brief period allowed for the review, unintentional misinformation from the corporate office, etc., were equally frustrating to us. Indeed, given that the team at least knew the specific nature of the concern they had been sent to investigate, the events of the day were in some ways even more frustrating for us.

Again, in all candor, the perceptions drawn by the team and stated during the exit interview were, for the most part, fairly arrived at and perhaps quite logical given the circumstances which existed at the time of the visit. However, as the forthcoming interim response will confirm, the "facts" are far different than the "perception". The facts are that circumstances, rather than intent, prohibited us from initially providing much of the data requested by the team. And, the facts are that IADE American Schools, as soon as this problem was discovered, acted in a matter of days, rather than weeks or months, to identify the cause and extent of the problem, to make full restitution to the U.S. Department of Education for all improperly disbursed funds, and to place additional controls to ensure that such a breakdown in institutional safeguards never occurs again.

In addition to laying out the nature of the original concern and documenting its correction, the institution also believes it important to comment regarding certain specific aspects of the complaint which precipitated the unannounced visit. IADE fully understands and appreciates the

Commission's responsibility to follow-up on any and all complaints associated with this and other member institutions. However, the manner in which this problem appears to have been brought to the attention of the Commission continues to raise serious questions regarding the methods and motives of the disgruntled current or former employee whose complaint precipitated the visit. Please consider the following points:

This person sent the Commission a copy of a letter from California's Council for Private Postsecondary and Vocational Education (CPPVE) which discussed only the alleged findings associated with a routine review of IADE's ESL programs. The disgruntled party who forwarded this item to the Commission failed to send either IADE's original or subsequent response to the CPPVE review. It seems relatively implausible that the party in question had access to the CPPVE letter yet, did not have access to these other documents. It is clear that the party in question selectively chose only the documents which suited his/her purpose -- attempting to discredit the institution.

Indeed, when a representative of the review team, at IADE's insistence, contacted CPPVE official, Jim Henthorn, Mr. Henthorn confirmed that, contrary to what was stated in the letter received by ACCET, IADE had in fact provided all refund related information requested by CPPVE. In a subsequent discussions with Mr. Henthorn, which occurred on the Monday following the Commission visit, he also expressed concern regarding two other related matters. The first concern was that, though the report was a matter of public record, it was sent without CPPVE's knowledge or consent. The second, was that it was sent without accompanying institutional documents and correspondence necessary to place the report in the proper context. It is CPPVE's standard procedure to include all related documents when forwarding it's review reports to other oversight agencies. You may, of course confirm these points with Mr. Henthorn at (916) 322-2614.

IADE is even more concerned regarding the issue of why this party choose to bring this matter to the attention of the Commission, prior to bringing it to the attention of IADE's senior management in order to solve the problem. As I believe our prompt response to this issue demonstrates, IADE takes its Title IV aid program responsibilities. In can assure you, that on an issue of such importance, IADE would have moved just as rapidly to resolve this issue if it had been brought to our attention by an employee as we did when it was discovered by the Commission.

Perhaps most seriously, we are concerned regarding a certain irony represented by these circumstances. IADE was not informed as to whether the party who presented this complaint was known or did so anonymously. However, it is reasonable, based on the types of documents which accompanied the complaint, to assume that the disgruntled party was, or is, a member of

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Roger Williams
IADE Schools Feb. '95 Visit
March 2, 1995; page 5

IADE's Office of Education and or acted in collusion with current of former education office staff. As this correspondence and the forthcoming interim response will confirm, inadvertent enrollment status reporting errors by staff in the Education Office are what originally caused a limited number of no-show students to receive aid in the first place. As such, the irony is that the disgruntled party who created and or contributed to the problem is the same party attempting to shift the blame to the institution. The fact of the matter is, as with all postsecondary institutions, institutional checks, balances and controls only work as well as the personnel who implement them.

These concerns aside, however, IADE is simply glad that the problem was brought to our attention and has now been resolved. Though we will obviously disclosed the nature this finding to the U.S. Department of Education when we make restitution for the improperly disbursed funds, IADE is well aware that had the Department, rather than the Commission, been the first to discovered this concern prior to IADE having identified and corrected the problem, the consequences could have been quite severe. Consequently, in closing, I wish to extend my personal thanks, and that of IADE American Schools, to the members of the team, yourself and the Commission as a whole helping IADE to both identify and resolve this problem. We have incorporated the input from this visit as part of the learning process and believe this institution as been strengthened because of it.

Thank you for the opportunity to provide this preliminary response. Should you have questions or wish to discuss these issues, please feel free to contact me. As indicated at previously, I fully expect to receive the completed CPA audit report with the next week or so, at which time IADE will make final payment of the anticipated liability and forward the completed **"Interim Response and Corrective Action Plan to February 3, 1995 ACCET Team Visit"**

Sincerely,

Abraham Stofenmacher
President

Senate Permanent Subcommittee on Investigations

EXHIBIT # 28

BET TZEDEK LEGAL SERVICES

145 South Fairfax Avenue, Suite 200, Los Angeles, California 90036 (213) 939-0506
Fax: (213) 549-5880

May 24, 1995

Mark Webster
United States Senate
Committee on Governmental Affairs
Chief Counsel to the Minority
Permanent Subcommittee on Investigations
Washington, D.C. 20510

Dear Mr. Webster:

I am sending you a copy of the written statement I mailed today to Dan Gelber. As you know, I have also been trying to collect declarations from students and former employees. As soon as I can obtain the signed declarations from the students, I will mail them to you. I have also spoken to a number of former employees, all of whom told me they have already been in touch with you. Therefore, I am not sending you any new declarations from former employees.

Please contact me if you find that the enclosed statement is too long and/or if you feel any changes are necessary. As you know, I will be on vacation from May 30 through June 14. I will be in Washington, D.C. part of this time. You can leave a message for me in Washington through June 1 at this number: (202) 265-7299. After that time, you can leave a message for me at my office: (213) 549-5842 as I will be checking my messages periodically. If you would like to make any changes and need me to sign a new statement, I can come in to your offices while I'm in Washington.

I'm sorry I won't be able to attend the hearings, but I appreciate your keeping me posted on your activities. I look forward to receiving the hearing transcript and any other information.

Thanks so much for your perseverance on this issue. Please don't hesitate to call me if you need anything else.

Very truly yours,

BET TZEDEK LEGAL SERVICES

By: _____
Deanne Loonin
Staff Attorney

BET TZEDEK LEGAL SERVICES

145 South Fairfax Avenue, Suite 200, Los Angeles, California 90036 (213) 939-0506
Fax: (213) 549-5880

WRITTEN STATEMENT OF BET TZEDEK LEGAL SERVICES
TO THE U.S. SENATE COMMITTEE ON GOVERNMENTAL AFFAIRS
PERMANENT SUBCOMMITTEE ON INVESTIGATIONS

The closure of six Southern California campuses of IADE American Schools (IADE) in March 1995, and the subsequent disappearance of the school's owners, left behind more than the shattered ambitions of thousands of mostly Latino students striving for better lives. The closures also left taxpayers footing a bill in the millions due to student loan and Pell grant fraud, an expense that could have been avoided if the Department of Education's regulations had been properly enforced.

The federal and state investigations that led to IADE's closure alleged improper handling of grant funds, failure to reimburse the government for loan and grant money and improper verification of applicants, particularly in the English as a Second Language (ESL) programs.

The warning signs of serious abuses at IADE were apparent long before the 1995 closure. As a staff attorney with Bet Tzedek Legal Services, a non-profit legal services organization which provides free legal assistance to low-income individuals throughout the Los Angeles area, I have been hearing complaints about IADE from students and former employees for years.

Bet Tzedek has successfully advocated on behalf of many of these students, helping them obtain funds to pay back loans mostly from the school or from the state tuition recovery fund. For example, in 1994, Bet Tzedek sued IADE on behalf of eleven former students of IADE's automobile technician course. The complaint alleged that IADE lured these students to the program with promises of employment, quality hands-on training and "free" education through readily available government funds.

Only after they enrolled and signed student loan and grant documents did the students find that most of the promises made to them were not true. Among other problems, the school offered little or no equipment for hands-on training and students with vastly different levels of ability and experience were merged into the same classes. Moreover, classes were inadequately supervised and frequently interrupted so that students could sign loan documents and other documents relating to financial assistance. When the students inquired about withdrawing, they were told,

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contrary to federal and state law, that even if they withdrew from the school, they would still have to pay back the entire amount of their loans.

Fortunately, these students were able to settle the case satisfactorily before IADE closed. Many other students were not so fortunate.

For example, last year I met with another group of Spanish-speaking former students of IADE's automobile technician course. This group had advocated strongly for themselves, complaining about IADE to, among other agencies, the Los Angeles Consumer Affairs Department and the California Council for Private and Postsecondary Vocational Education. Representatives from these agencies met with the students, but other than conducting a few on-site inspections of IADE, failed to take any serious action against the school until about five years after the students' graduation. By the time this group contacted Bet Tzedek, the statute of limitations to sue or even to file a complaint with the state for a refund had expired. In the end, only IADE profited from the government funds and the students are left saddled with debt, due to student loans from which they received no benefit.

These students' plight is not unique. The Council in California and the federal Department of Education received countless complaints about IADE throughout the years. The enforcement system simply took too long.

On the federal level, the enforcement responsibility for loan and grant assistance lies with the Department of Education. Specifically, in order to receive federal loans or grants, a school must be authorized to offer the program by the state in which they are located, must be accredited by a nationally recognized accreditor approved by the Department, and must be certified and determined to be eligible by the Department.

Lax enforcement of these regulations has allowed schools like IADE to thrive despite mounting evidence of fraud and corruption. Schools such as IADE can be extremely resilient in avoiding sanctions and/or closure by the government. For example, when IADE began to feel pressure in the early 1990's due to high default rates in their student loan program, they simply ceased their participation in the loan program and switched to offering Pell grants only. This move allowed them to stay alive for at least another three or four years.

In 1993, this Committee conducted hearings on Pell grant fraud-- the same issue that they face today. The hearing report highlighted major abuses in the system including:
Schools that set tuition at artificially high levels;
Schools that disbursed funds to ineligible students;
Schools that paid brokers to recruit students; and

Schools that falsified grant documents.

IADE has been charged with nearly all of these violations and more.

Unfortunately, IADE is not alone. Even though the Department and California's Council have caught up with some of the most egregious offenders in the past few years, advocacy organizations such as Bet Tzedek continue to hear regularly from victims of financial aid abuse.

In fact, the problem probably is even greater than we are able to track, primarily because recipients of Pell grant funds do not have to pay the money back and therefore are less likely to seek legal assistance than recipients of student loans. Although Pell grant recipients often feel cheated, they are not facing the monthly payments and harassment by collection agencies and creditors that drive many loan recipients to seek assistance.

The human toll of lax enforcement is great. Most of the students who attend these schools are seeking better lives for themselves and their families. Their dreams of upward mobility through education are too often thwarted by unscrupulous schools that leave them in debt and often unable to qualify for future government assistance to attend legitimate schools.

Congress opened up federal aid programs to vocational school students, including students without high school diplomas, with the goal of providing more equal access to education. This worthy goal should not be lost in this debate. However, without proper enforcement of the Department's regulations, equal access to government aid becomes a fiction for all too many vocational school students. We hope that these hearings, combined with previous hearings and testimony compiled by this Committee, will sound an alarm to the Department and other enforcement agencies, not to cut off assistance for students, but to ensure that the system is properly regulated.

DATED: May 25, 1995

Submitted By:

BET TZEDEK LEGAL SERVICES

By: _____
Deanne Loonin
Staff Attorney

ED's CASH ON HAND RECONCILIATION SPREADSHEET PER FISCAL YEAR for

'IN No. X580 NAME: IADE AMERICAN SCHOOLS

ADVANCES PAID by ED to PIN X580		PIN X580's REPORTED TOTAL CUMULATIVE EXPENDITURES by AWARD by Fiscal Year		ED's CASH ON HAND by Fiscal Year	ED's CUMULATIVE CASH ON HAND	
Schedule #	$	Schedule/Award #	$			
ISCAL YEAR 1 through 6 (7/1/74 to 6/30/87)						
Sch. 3: HHS advances	$0.00	Sch. 3: HHS closed awards TCE, Total Amount	$0.00			
		Sch. 10: HHS award load adjustment, Total Amount	$0.00			
Sch. 2: EDPMTS advances	$0.00	Sch. 9: EDPMTS closed awards TCE, Total Amount	$0.00			
Sch. 1: EDPMS advances	$0.00	Sch. 8: EDPMS purged awards TCE, Total Amount	$0.00			
Less: EDPMS/EDPMTS load $	$0.00	Sch. 7: EDPMS archived awards TCE, Total amount	$0.00			
		Sch. 6: EDPMS closed awards TCE, Total Amount	$0.00			
		Sch. 4: EDPMS open awards TCE, Total Amount	$0.00			
Total FY 1 – 6	$0.00		$0.00	$0.00	$0.00	

Fiscal Year 1 – 6: All amounts entered for this time period are total amounts for each schedule.

Fiscal Year 7 – 12: Schedule 1, EDPMS advances are listed for each month. Schedule 4 and 6, each award's expenditures are li
:cal year that the recipient reported the expenditure in. The award could be listed in more than one fiscal year. Schedule 5, Award ex
djustments after the Reconciliation's Period Ending Date. Schedule 7, each award's archived expenditure is listed under the fiscal ye
ward's beginning budget period commenced in.

FB Sch. B

Completed on 02-May-95

Page 1

Senate Permanent Subcommittee on Investigations
EXHIBIT # 32

183

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ED's CASH ON HAND RECONCILIATION SPREADSHEET PER FISCAL YEAR for

'IN No. X580 NAME: IADE AMERICAN SCHOOLS

ADVANCES PAID by ED to PIN X580		PIN X580's REPORTED TOTAL CUMULATIVE EXPENDITURES by AWARD by Fiscal Year		ED's CASH ON HAND by Fiscal Year	ED's CUMULATIVE CASH ON HAND	
Schedule #	$	Schedule/Award #	$			
ISCAL YEAR 7 (7/1/87 to 6/30/88)						
Sch. 1: EDPMS advances						
Jul-87	$0.00					
Aug-87	$0.00					
Sep-87	$0.00					
Oct-87	$0.00					
Nov-87	$0.00					
Dec-87	$0.00					
Jan-88	$0.00					
Feb-88	$0.00					
Mar-88	$0.00					
Apr-88	$0.00					
May-88	$0.00					
Jun-88	$0.00					
Total FY 7	$0.00		$0.00	$0.00	$0.00	

192

184

ED's CASH ON HAND RECONCILIATION SPREADSHEET PER FISCAL YEAR for
PIN No. X580 NAME: IADE AMERICAN SCHOOLS

ADVANCES PAID by ED to PIN X580 Schedule #	$	PIN X580's REPORTED TOTAL CUMULATIVE EXPENDITURES by AWARD by Fiscal Year Schedule/Award #	$	ED's CASH ON HAND by Fiscal Year	ED's CUMULATIVE CASH ON HAND
FISCAL YEAR 8 (7/1/88 to 6/30/89)					
Sch. 1: EDPMS advances					
Jul-88	$0.00				
Aug-88	$0.00				
Sep-88	$0.00				
Oct-88	$0.00				
Nov-88	$0.00				
Dec-88	$0.00				
Jan-89	$0.00				
Feb-89	$0.00				
Mar-89	$0.00				
Apr-89	$0.00				
May-89	$0.00				
Jun-89	$0.00				
Total FY 8	$0.00		$0.00	$0.00	$0.00

ED's CASH ON HAND RECONCILIATION SPREADSHEET PER FISCAL YEAR for

PIN No. X580 NAME: IADE AMERICAN SCHOOLS

ADVANCES PAID by ED to PIN X580		PIN X580's REPORTED TOTAL CUMULATIVE EXPENDITURES by AWARD by Fiscal Year		ED's CASH ON HAND by Fiscal Year	ED's CUMULATIVE CASH ON HAND
Schedule #	$	Schedule/Award #	$		
FISCAL YEAR 9 (7/1/89 to 6/30/90)			REPORTED	EDPMS MONTHLY	QRTLY/MONTHLY
Sch. 1: EDPMS advances		AWARD #	EXPENDITURE	COH BALANCE	COH BALANCE
Jul-89	$0.00				
Aug-89	$0.00				
Sep-89	$0.00				$0.00
Oct-89	$0.00				
Nov-89	$0.00				
Dec-89	$1.00	P063P97691	$14,227.00	($14,226.00)	($14,226.00)
Jan-90	$83,061.00				
Feb-90	$180,009.00				
Mar-90	$182,961.00	P063P97691	$312,736.05	$113,294.95	$99,068.95
Apr-90	$100,000.00				
May-90	$160,000.00				
Jun-90	$60,000.00	P063P97691	$501,362.95	($181,362.95)	($82,294.00)
				($82,294.00)	
Total FY 9	$766,032.00		$828,326.00	($82,294.00)	($82,294.00)

194

186

ED's CASH ON HAND RECONCILIATION SPREADSHEET PER FISCAL YEAR for

PIN No. X580 NAME: IADE AMERICAN SCHOOLS

ADVANCES PAID by ED to PIN X580		PIN X580's REPORTED TOTAL CUMULATIVE EXPENDITURES by AWARD by Fiscal Year		ED's CASH ON HAND by Fiscal Year	ED's CUMULATIVE CASH ON HAND
Schedule #	$	Schedule/Award #	$		
FISCAL YEAR 10 (7/1/90 to 6/30/91)			REPORTED	EDPMS MONTHLY	CMTLY/MONTHLY
Sch. 1: EDPMS advances		AWARD #	EXPENDITURE	COH BALANCE	COH BALANCE
					($82,294.00)
Jul-90	$200,000.00				
Aug-90	$225,000.00				
Sep-90	$200,000.00	P063P97691	$4,860.59		
		P063P07691	$477,911.96	$142,227.45	$79,933.45
Oct-90	$150,482.00				
Nov-90	$177,664.00				
Dec-90	$232,189.00	P063P97691	$1,779.30		
		P063P07691	$568,175.09	($7,669.39)	$72,264.06
Jan-91	$119,100.00				
Feb-91	$406,875.00				
Mar-91	$306,826.00	P063P97691	($1,636.89)		
		P063P07691	$866,739.18	($62,497.29)	$9,766.77
Apr-91	$726,082.00				
May-91	$426,720.00				
Jun-91	$368,090.00	P063P07691	$1,278,736.07	$242,155.93	$251,922.70
				$314,216.70	
Total FY 10	$3,540,780.00		$3,226,563.30	$314,216.70	$251,922.70

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ED's CASH ON HAND RECONCILIATION SPREADSHEET PER FISCAL YEAR for

PIN No. X580 NAME: IADE AMERICAN SCHOOLS

ADVANCES PAID by ED to PIN X580		PIN X580's REPORTED TOTAL CUMULATIVE EXPENDITURES by AWARD by Fiscal Year		ED's CASH ON HAND by Fiscal Year	ED's CUMULATIVE CASH ON HAND
Schedule #	$	Schedule/Award #	$		
FISCAL YEAR 11 (7/1/91 to 6/30/92)			REPORTED	EDPMS MONTHLY	CRTLY/MONTHLY
Sch. 1: EDPMS advances		AWARD #	EXPENDITURE	COH BALANCE	COH BALANCE
					$251,922.70
Jul-91	$900,000.00				
Aug-91	$750,000.00				
Sep-91	$820,000.00	P063P07691	($46,617.01)		
		P063P17691	$2,457,305.80	$59,211.21	$311,133.91
Oct-91	$740,000.00				
Nov-91	$800,000.00				
Dec-91	$792,000.00	P063P07691	($40,904.29)		
		P063P17691	$2,279,984.50	$92,919.79	$404,053.70
Jan-92	$1,020,000.00				
Feb-92	$1,025,000.00				
Mar-92	$596,577.00	P063P07691	($215.00)		
		P063P17691	$2,905,825.55	($324,033.55)	$80,020.15
Apr-92	$1,429,500.00				
May-92	$738,525.00				
Jun-92	$691,700.00	P063P17691	$2,873,708.16	($13,983.15)	$66,037.00
				($185,885.70)	
Total FY 11	$10,303,302.00		$10,469,197.70	($185,885.70)	$66,037.00

198

ED's CASH ON HAND RECONCILIATION SPREADSHEET PER FISCAL YEAR for

PIN No. X580 NAME: IADE AMERICAN SCHOOLS

ADVANCES PAID by ED to PIN X580 Schedule #	$	PIN X580's REPORTED TOTAL CUMULATIVE EXPENDITURES by AWARD by Fiscal Year Schedule/Award #	$	ED's CASH ON HAND by Fiscal Year	ED's CUMULATIVE CASH ON HAND	
FISCAL YEAR 12 (7/1/92 to 6/30/93)			REPORTED	EDPMS MONTHLY	QRTLY/MONTHLY	NOTE
Sch. 1: EDPMS advances		AWARD #	EXPENDITURE	COH BALANCE	COH BALANCE	CODE
					$88,037.00	
Jul-92	$2,381,593.00					
Aug-92	$1,500,000.00					
Sep-92	$1,775,000.00	P063P07691	($41,788.23)			
		P063P17691	($188,991.00)			
MEERS reporting started		P063P27691	$6,007,276.00	($119,923.77)	($53,886.77)	
Oct-92	$0.00					
Nov-92	$783,406.00			$783,406.00	$729,519.23	A
Dec-92	$2,348,669.00			$2,348,669.00	$3,078,188.23	A
Jan-93	$1,400,000.00	P063P07691	$1,758.64			
		P063P17691	$25,141.69			
		P063P27691	$4,017,040.00	($2,643,940.33)	$434,247.90	B
Feb-93	$850,000.00	P063P07691	($338.97)			
		P063P17691	($26,983.69)			
		P063P27691	$1,287,172.00	($407,849.34)	$26,398.56	B
Mar-93	$1,450,000.00	P063P17691	$29,675.00			
		P063P27691	$1,385,114.36	$35,210.64	$61,609.20	B
Apr-93	$1,090,000.00	P063P17691	$0.00			
		P063P27691	$788,157.00	$301,843.00	$363,452.20	B
May-93	$1,015,000.00	P063P07691	$57.03			
		P063P17691	($29,675.00)			
		P063P27691	$802,673.00	$241,944.97	$605,397.17	C
Jun-93	$249,345.00	P063P27691	$368,998.31	($119,653.31)	$485,743.86	C
				$419,706.86		
Total FY 12	$14,843,013.00		$14,423,306.14	$419,706.86	$485,743.86	

NOTES: A – Grantee is being transferred from quarterly to monthly EDPMS reporting. Grantee experienced problems in converting from hard copy (quarterly) to electronic (monthly) reporting. As a result, the Grantee was not cited for excess cash on hand.

B – Account monitored. Payments received at end of month indicates the ending cash on hand is not excess.

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ED's CASH ON HAND RECONCILIATION SPREADSHEET PER FISCAL YEAR for

PIN No. X580 NAME: IADE AMERICAN SCHOOLS

ADVANCES PAID by ED to PIN X580 Schedule #	$	PIN X580's REPORTED TOTAL CUMULATIVE EXPENDITURES by AWARD by Fiscal Year Schedule/Award #	$	ED's CASH ON HAND by Fiscal Year	ED's CUMULATIVE CASH ON HAND	
FISCAL YEAR 13 (7/1/93 to 6/30/94) Sch. 1: EDPMS advances		AWARD #	REPORTED EXPENDITURE	EDPMS MONTHLY COH BALANCE	ORTLY/MONTHLY COH BALANCE $485,743.86	NOTE CODE
Jul - 93	$2,500,000.00	P063P27691	($57,293.67)			
		P063P37691	$2,990,077.00	($422,783.33)	$82,960.53	C
Aug - 93	$1,585,000.00	P063P27691	$118,296.00			
		P063P37691	$1,583,102.00	($116,396.00)	($53,437.47)	
Sep - 93	$1,820,000.00	P063P07691	$281.94			
		P063P27691	($185,809.85)			
		P063P37691	$1,071,425.00	$934,102.91	$880,665.44	C
Oct - 93	$860,000.00	P063P27691	$8,887.00			
		P063P37691	$1,551,900.00	($700,787.00)	$179,878.44	B
Nov - 93	$1,380,000.00	P063P27691	($5,897.15)			
		P063P37691	$1,261,204.00	$124,693.15	$304,571.59	B
Dec - 93	$1,433,000.00	P063P37691	$1,301,243.00	$131,757.00	$436,328.59	B
Jan - 94	$1,304,000.00	P063P37691	$1,698,718.00	($394,718.00)	$41,610.59	B
Feb - 94	$1,448,000.00	P063P37691	$1,482,722.00	($34,722.00)	$6,888.59	B
Mar - 94	$1,592,000.00	P063P37691	$1,486,556.00	$105,444.00	$112,332.59	B
Apr - 94	$1,657,000.00			$1,657,000.00	$1,769,332.59	D
May - 94	$984,769.00	P063P37691	$2,484,221.71	($1,499,452.71)	$269,879.88	C & E
Jun - 94	$0.00	P063P37691	$665,175.71	($665,175.71)	($395,295.83)	E
				($881,039.69)		
Total FY 13	$16,563,769.00		$17,444,808.69	($881,039.69)	($395,295.83)	

NOTES: C – Grantee was cited for having excess cash on hand. IADE's ability to draw funds was suspended.

D – IADE submitted the EDPMS 272 report after the due date. The report indicated the ending cash on hand amount would have been $112,879.59 if the report had been posted. Ending cash on hand was not excess. See Note B.

E – The program office requested a stop payment action be placed on IADE's account on May 16 and removed on June 29, 1994.

190

198

ED's CASH ON HAND RECONCILIATION SPREADSHEET PER FISCAL YEAR for

PIN No. - X580 NAME: IADE AMERICAN SCHOOLS

ADVANCES PAID by ED to PIN X580 Schedule #	$	PIN X580's REPORTED TOTAL CUMULATIVE EXPENDITURES by AWARD by Fiscal Year Schedule/Award #	$	ED's CASH ON HAND by Fiscal Year	ED's CUMULATIVE CASH ON HAND	
FISCAL YEAR 14 (7/1/94 to 6/30/95)		AWARD #	REPORTED EXPENDITURE	EDPMS MONTHLY COH BALANCE	QRTLY/MONTHLY COH BALANCE ($305,295.83)	NOTE CODE
Sch. 1: EDPMS advances						
Jul-94	$3,030,000.00	P063P37691	($704,917.42)			
		P063P47691	$3,201,179.00	$533,738.42	$136,442.59	B
Aug-94	$1,317,000.00	P063P37691	$257,251.28			
		P063P47691	$1,542,965.00	($483,216.28)	($344,773.69)	
Sep-94	$1,281,000.00	P063P37691	($582,479.28)			
		P063P47691	$1,486,256.00	$377,223.28	$32,449.59	B
Oct-94	$1,489,000.00	P063P37691	($20,546.00)			
		P063P47691	$1,509,648.00	($102.00)	$32,347.59	B
Nov-94	$1,279,000.00	P063P27691	($82,366.00)			
		P063P47691	$1,419,326.00	($57,960.00)	($25,612.41)	
Dec-94	$1,558,715.00	P063P47691	$1,520,773.00	$37,942.00	$12,329.59	B
Jan-95	$384,000.00	P063P37691	$44,624.00			
		P063P47691	$773,633.00	$165,743.00	$178,072.59	C
Feb-95	$738,300.00	P063P37691	($89,248.00)	$827,548.00	$1,005,620.59	C, F, G
Apr-95		P063P37691	($11,805.00)	$11,805.00	$1,017,425.59	C, F, G
		Sch. 5 EDPMS award				
		Adj. total	$11,805.00	($11,805.00)	$1,005,620.59	
				$1,400,916.42		
Total FY 14						
	$11,677,015.00		$10,276,098.58	$1,400,916.42	$1,005,620.59	

NOTES: F – The program office requested a stop payment action be placed on IADE's account on February 24, 1995. IADE's last draw was on February 23 for $145,000.

G – IADE has not submitted an EDPMS 272 report since their account was placed on stop pay in February of 1995. The March report was returned by the post office as "IADE American Schools, moved, left no address, unable to forward, return to sender".

ED's CASH ON HAND RECONCILIATION SPREADSHEET PER FISCAL YEAR for

IN No. - X580 NAME: IADE AMERICAN SCHOOLS

	ADVANCES PAID by ED to PIN X580	PIN X580's REPORTED TOTAL CUMULATIVE EXPENDITURES by AWARD by Fiscal Year	ED's CASH ON HAND by Fiscal Year	ED's CUMULATIVE CASH ON HAND	
Schedule #	$	Schedule/Award # $			
Total FY 1 – 6 TOTAL ADVANCES / EXPENDITURES SUMMARIZATION BY FISCAL YEAR (7/1/74 to 6/30/87)					
Total FY 7 (7/1/87 to 6/30/88)	$0.00	$0.00	$0.00	$0.00	
TOTAL (FY 1 – 7)	$0.00	$0.00	$0.00	$0.00	
Total FY 8 (7/1/88 to 5/	$0.00	$0.00	$0.00		
Total FY 9 (7/1/89 to 6/30/90)	$0.00	$0.00	$0.00	$0.00	
Total FY 10 (7/1/90 to 6/30/91)	$766,032.00	$828,326.00	($62,294.00)	($62,294.00)	
Total FY 11 (7/1/91 to 6/30/92)	$3,540,780.00	$3,226,563.30	$314,216.70	$251,922.70	
TOTAL (FY 8 – 11)	$10,303,302.00	$10,480,187.70	($185,885.70)	$66,037.00	
Total FY 12 (7/1/92 to 6/30/93)	$14,610,114.00	$14,544,077.00	$66,037.00		
Total FY 13 (7/1/93 to 6/30/94)	$14,843,013.00	$14,423,306.14	$419,706.86	$485,743.86	
Total FY 14 (7/1/94 to 6/30/95)	$16,563,769.00	$17,444,808.69	($881,039.69)	($395,295.83)	
TOTAL (FY 12 – 14)	$11,677,015.00	$10,276,098.58	$1,400,916.42	$1,005,620.59	
	$43,083,797.00	$42,144,213.41	$32,607,698.42		
GRAND TOTAL (FY 1 – 14)	$57,693,911.00	$56,688,290.41		$1,005,620.59	

RECONCILED CASH on HAND for Period Ending Date of 28–Feb–95

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Senate Permanent Subcommittee
on Investigations
EXHIBIT # 34

UNITED STATES DEPARTMENT OF EDUCATION
WASHINGTON, D.C. 20202-

26 1995

R. Mark Webster
Investigator to the Minority
Permanent Subcommittee on Investigations
U.S. Senate
193 Russell Senate Office Building
Washington, DC 20510

RE: Request for Federal Pell Grant program data, including IADE American schools

Dear Mr. Webster:

Enclosed are the data reports you requested for 1989-90 through 1994-95. We selected all schools with Federal Pell Grant funding equal to or greater than IADE American (026088). The reports are in descending order by funding level. The results are:

Year	IADE Funding	Rank
1989-90	$ 833,327	1404th
1990-91	$ 3,093,634	316th
1991-92	$ 10,383,991	30th
1992-93	$ 14,452,247	19th
1993-94	$ 16,459,224	15th
1994-95	$ 13,828,673	18th

Please note that the City University of New York's Federal Pell Grant authorization is given by adding together Pell Institution Numbers 002686 and 022222, beginning with school year 1991-92. CUNY is the only school with an authorization in excess of $99,999,999.

The data for 1994-95 are not yet complete. Schools funded at $750,000 or above had a mandatory reporting period for 1994-95 which ended on June 15, 1995; all funded schools have a mandatory reporting period ending August 15, 1995. In addition, institutions have until September 30, 1995 to submit final reports.

Our mission is to ensure equal access to education and to promote educational excellence throughout the Nation.

Should you have any questions or need additional information, please let Jana Henderson of my staff (708-8698) know. Thank you.

Sincerely,

Jeanne B. Saunders
Director, Application and Pell
Processing Systems Division
Program Systems Service

Enclosures (6)

cc: Linda Paulsen
Michele Selvage
Jana Henderson

Law Offices
MARY GIBBONS, ESQ.
727 West 7th Street, Suite 929
Los Angeles, California 90017

(818) 980-5164 *Fax: (818) 980-5164*

Senate Permanent Subcommittee on Investigations
EXHIBIT # 37

May 16, 1995

BY FACSIMILE TRANSMISSION/ORIGINAL BY MAIL

R. Mark Webster
Staff Investigator
Minority Subcommittee on Investigations
Committee on Governmental Affairs
United States Senate
Washington, D.C. 20510-6250

Dear Mr. Webster:

This letter will confirm our conversations regarding various aspects of the ongoing investigation involving my client, IADE American Schools (herein "IADE").

Initially, your office issued a deposition subpoena directed to Mr. Bernardo Stofenmacher on March 24, 1995, returnable on April 12, 1995. As outside counsel for IADE American Schools, Mr. Treviño and I agreed to accept service of such subpoena on his behalf. I informed you that, in light of the fact that the Federal Bureau of Investigation, together with the Office of the United States Attorney for the Central District of California, is conducting an investigation of IADE, Bernardo Stofenmacher, as an officer of the corporation, would invoke his Fifth Amendment privilege against self-incrimination as to any inquiry concerning IADE or the activities of its officers and employees. You agreed that, given his intention to invoke this privilege, it would not be necessary for him to appear in person for a deposition in response to such subpoena, nor would it be necessary for him to invoke the privilege on a question-by-question basis.

On April 27, 1995, you requested that IADE produce, pursuant to your subpoena of May 10, 1994 directed to IADE, documents identifying the students who participated in the COTC citizenship training program since 1992. We are presently seeking to identify the responsive materials, which is a extremely difficult task at this juncture. As you know, IADE has ceased operations and has filed for bankruptcy. Many company documents were seized by the FBI and those which were not seized are being moved to a central location due to the fact that various school locations have been closed, with leases being terminated, etc. Consequently, although the company is making an effort to collect the material which you requested, we are not in a position to provide a response as yet. I understand your time constraints, however it simply has not been possible to produce the materials which you requested. We hope to be able to inform

you as to what materials are and are not available by early next week.

In light of the general difficulty in locating corporate documents, it would be most helpful if you could provide me, by fax, with a copy of the original subpoena pursuant to which these COTC documents have been requested.

We have also discussed the issuance and service of subpoenas for certain corporate officers to be returnable at the upcoming hearing which you indicated might be held on June 13. I am willing to accept service of such subpoena on behalf of Bernardo Stofenmacher, but I am not authorized to accept service on behalf of Sergio Stofenmacher. Of course, you understand that the acceptance of service of such any such subpoena does not in any way waive any arguments which may lie in support of a motion to quash, apart, of course, from service issues.

Thank you very much for your co-operation in this matter.

Very truly yours,

Mary Gibbons

cc: Phillip A. Treviño
Gonzolo Freixes

MARK KARALLA, M.D.
OBSTETRICS GYNECOLOGY AND INFERTILITY
18370 BURBANK BL., SUITE 308
TARZANA, CALIFORNIA 91356
TELEPHONE (818) 881-5661

Senate Permanent Subcommittee on Investigations
EXHIBIT # 38

July 11, 1995

Re: Bernardo Stofenmacher
DOB: 9-24-66

To Whom It May Concern;

This letter is to inform you as to the condition of Bernardo Stofenmacher's spouse and his inability to travel at this time.

Mrs. Stofenmacher is currentley under my care for her pregnancy. She has what is known as a high risk pregnancy due to severe edema and possible macrosomia. Due to this condition she may have to undergo a C-Section.

As you can see it is imperative that Bernardo stay within close range to both his spouse and the hospital in case a complication arises. I therefor feel that at this point it is a medical necessity that he cancell any and all plans for travel.

If you have any further questions or require additional information, please feel free to call my office and my staff and I shall assist you as needed.

Thank you for your time.

Sincerely,

M. Karalla, MD

Mark Karalla, M.D.

MK/abg

Edema - she's swelling up big time
Macrosomia - the baby's big - may not go to term

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MARK KARALLA, M.D.
Obstetrics, Gynecology and Infertility
18370 Burbank Blvd., Suite 209
Tarzana, CA 91356
Phone (818) 881-5661
Fax (818) 881-6132

FACSIMILE COVER SHEET:

DATE: 7-11-95

TO B. Mark Webster - Staff Investigator
Minority Subcommittee on Governmental Affairs
U.S Senate Washington, DC

FROM:
Annette - Dr. Mark Karalla's Office

NUMBER OF PAGES: 2 (INCLUDING COVER SHEET)

MESSAGE: Re:
Bernardo Stofenmacher

IMPORTANT This message is intended only for the use of the individual to which it is addressed and may contain information that is privileged, confidential and exempt from disclosure under applicable law. If the reader of this message is not intended recipient or the agent or employee responsible for delivering the message to the intended recipeint, you are hereby notified that dissemination, distribution or copying of this communication in errer, please notify us immediately by telephone and return the original message to us at the above address VIA U.S. POSTAL SERVICE

Thank you.

Dr. Mark Karalla

Senate Permanent Subcommittee on Investigations
EXHIBIT # 39

UNITED STATES DEPARTMENT OF EDUCATION

OFFICE OF POSTSECONDARY EDUCATION

THE ASSISTANT SECRETARY

Senator Sam Nunn
Ranking Minority Member
Permanent Subcommittee
on Investigations
193 Russell Senate Office Building
Washington, DC 20510-6250

Dear Senator Nunn:

Enclosed are the corrections to the record for the July 12, 1995, hearing on "Abuses in Federal Student Grant Programs". These minor changes in the transcript are also accompanied by other material to be included in the printed record.

Thank you for the opportunity to make these changes. Should you have any additional questions pertaining to the enclosed material, please have a member of your staff contact me at (202) 708-5547.

Sincerely,

Diane E Rogers
for

David A. Longanecker

Question: The Subcommittee staff testified that the Department reversed its policy of conducting unannounced program reviews in March 1995, just nine months after the policy took effect. Why was this policy reversed? How many unannounced program reviews did you conduct in 1994? How many, if any, have you conducted in 1995? What circumstances must arise before you conduct an unannounced visit? Who has the authority to approve an unannounced review?

Answer: The Department stopped doing all of its institutional reviews on an unannounced basis for two reasons. First, we found that unannounced and announced reviews were equally effective in almost all cases. Second, announced reviews are more efficient. They give schools the time to prepare for the review and ensure that key personnel are available when our reviewers arrive. It costs us a great deal of staff time when we arrive at the institution and the people we need to speak with are unavailable because they did not know we were conducting a review.

The Department, however, has not abandoned the policy of conducting unannounced reviews. When circumstances arise that indicate the possibility that the institution is engaged in fraud or abuse, the Regional Director or the Department's Institutional Review Branch Chief will rely on his or her professional judgement to decide whether to conduct an unannounced review. These circumstances may include, but are not limited to, the following: complaints from law enforcement agencies, students, parents, and/or the Office of the General Counsel; negative reports from state agencies or accrediting agencies; information from former or current employees of the institution; or any other information which may indicate possible fraud or abuse.

In 1994, the Department conducted 135 unannounced reviews. In 1995, the Department has conducted 76 unannounced reviews (year-to-date).

Question: Why did the Department's Office of the General Counsel unilaterally agree to a settlement in June 1994, whereby IADE would be taken off the reimbursement system of funding for the student financial assistance (SFA) programs and restored to the advance system of funding, as the Subcommittee staff testified?

Answer: The Office of the General Counsel (OGC) did not unilaterally agree to this settlement. OGC was obligated to focus on the litigative risk of keeping IADE on reimbursement when IADE's attorney indicated that the school would seek a preliminary injunction compelling the Secretary of Education to remove it from reimbursement if the Department did not do so voluntarily. OGC's obligation in this regard derived not only from the need for the Department to act lawfully and avoid unnecessary litigation, but from the need to provide the Office of Postsecondary Education (OPE) with a reasonable assessment of the litigative risk. Accordingly, upon being advised of the possibility of suit, the cognizant OGC attorney proceeded to bring to the attention of cognizant OPE personnel the threatened suit, OGC's assessment of the likely result, and the content of IADE's proffered settlement offer.

As to the likely outcome of the suit, OGC advised that the Department would likely lose because the basis for the school's having been placed on reimbursement in May 1994 was the school's improper activities over a period that had ended three years earlier, and because there was no evidence that these improper activities had occurred more recently. Richard Nelson, of OPE's Region X, responded by memorandum that his only concern was that it might prove necessary to place IADE back on reimbursement shortly based on information not yet available. Ronald Lipton, Director of the Compliance and Enforcement Division, whose offices had responsibility for placing schools on reimbursement funding, or taking them off, agreed with OGC's assessment that IADE's offer of a letter of credit in exchange for removing the school from reimbursement funding was a good outcome for the Department, and he proceeded to take the school off reimbursement. Thus, to say that OGC "unilaterally" accepted the settlement offer is wholly inaccurate; rather, OPE, after consultation with OGC, accepted the offer.

Question: Can you describe the differences between the Pell Grant Program and the Direct Student Loan Program with regard to the application process and the disbursement of funds? In addition, what measures have you taken that will get the student, the beneficiary, more involved in the disbursement process?

Answer: A student applies for a Pell Grant and a Direct Loan through the same application process. To determine a student's eligibility, information on the application is electronically matched with information of other agencies, including the Immigration and Naturalization Service, the Social Security Administration, and the Selective Service. Furthermore, each applicant's name and Social Security number is checked against the Department's National Student Loan Data System (NSLDS) to determine whether the student is in default on a student loan, or has received an overpayment on a grant. Failure to meet these data base matches results in either a rejected application requiring corrected information or further documentation.

In addition to these central data base matches, students need to sign several certifications, including a statement of registration status, a statement of educational purpose, and a certification on refunds and default. When the application is processed, the student receives a Student Aid Report (SAR) and the school receives an Institutional Student Information Report (ISIR).

The process by which a student receives a Pell Grant is substantially different from the process by which a student receives a Direct Loan. A school may disburse a Pell Grant based on the timely receipt of a correct SAR or ISIR. A school only disburses a Direct Loan based on the timely receipt of a correct SAR or ISIR, and the timely receipt of a valid promissory note. In addition, first time Direct Loan recipients must receive an entrance loan interview before the funds are disbursed.

There are other significant differences between the disbursement of Pell Grants and Direct Loans. Unless a school is on the reimbursement system, all schools are able to draw down appropriate Pell Grant funds through the Department of Education's Payment Management System upon the timely receipt of a correct SAR or ISIR. Schools which are placed on the reimbursement system for Pell Grants do not have additional requirements for student notification, but they are required to provide student-level documentation to the Department before they can receive Pell Grant funds. The reimbursement system of payment is used to protect the federal fiscal interest as a result of program review or audit findings, or other concerns regarding the financial or administrative capability of the school.

Under Direct Loans, schools participate as either originators or alternate originators depending upon selection criteria. These selection criteria include a school's prior experience in administering Title IV funds. Originators may disburse funds to students based on the receipt of a promissory note, whereas alternate originators must submit the loan origination records and promissory notes to the Department of Education's servicer for approval before funds are

disbursed.

Finally, under the Direct Loan Program, the student, the beneficiary of the program, is always in the loop in terms of direct acknowledgment to the Department of Education. In the case of both Direct Loan originating and alternate originating schools, the student receives a letter from the Department of Education's servicer ten days after the loan is booked. A loan is booked when the servicer receives the loan origination record, signed promissory note, and disbursement record from the school. The letter confirms the amount and date of the direct loan disbursement and details the borrower's rights and responsibilities. The student receives a letter after each direct loan disbursement. In addition, each June, the borrower receives an annual statement from the servicer listing the aggregate loan amounts.

In an effort to strengthen the involvement of students to enhance the integrity of the Pell Grant Program, Deputy Secretary Kunin has convened a Department-wide team to streamline and reform the entire Title IV delivery system. This team is expected to propose major changes in both the rules and the operations of the delivery system, including any legislative proposals that may be required. Careful consideration will be given to the practicality and cost of reforms, as well as to their effect on both program integrity and burden reduction. This team expects to complete their work by early 1996.

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Question: The Subcommittee staff testified that the IADE case is symptomatic of deeper problems within the Department, specifically that, according to members of your own staff, Senior Management is not committed to strong gatekeeping and is able to be swayed by political pressure. How do you respond to these allegations?

Answer: Since Secretary Riley, Deputy Secretary Kunin, and I came to the Department, we have improved the way in which we do business. This is demonstrated by the decreasing number of institutions now being accepted for eligibility into the Title IV student financial assistance programs and the increasing number of institutions being denied eligibility. IADE could not happen today using the preventive tools we have put in place, such as the 85-15 rule, annual financial audits and other changes enacted as a result of the 1992 amendments to the Higher Education Act. Without a doubt, the Department is committed to the task of tough, but fair, gatekeeping and oversight responsibilities; indeed, gatekeeping is currently designated as one of the Department's highest strategic planning priorities.

I also remain committed to our new approach to gatekeeping and institutional oversight under the management philosophy that Secretary Riley, Deputy Secretary Kunin, and I are pursuing. We believe that the Department needs to operate more in alignment with modern quality management principles, which includes investing greater responsibility in better trained and more highly competent employees. As in every organization, a new alignment of priorities and changes requires the Senior Managers of that entity to make some tough decisions that may not be liked by all.

Finally, I feel it is important to mention that had the subcommittee staff discussed the specific allegations concerning personnel matters in the same level of detail they afforded my staff, I would have been able to correct a number of errors and misrepresentations that now appear in the record. In the end, we might have been able to avoid the unnecessary airing of these issues, as I do not believe personnel matters should be discussed in such a public forum.

Senate Permanent Subcommittee on Investigations
EXHIBIT # 41

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF INSPECTOR GENERAL

THE INSPECTOR GENERAL

September 14, 1995

Mr. Dan Gelber
Chief Counsel to the Minority
Permanent Subcommittee on Investigation
United States Senate
Committee on Governmental Affairs
Washington, DC 20510

Dear Mr. Gelber:

Enclosed, in response to your recent request, are replies to questions raised by the Permanent Subcommittee on Investigations subsequent to the Subcommittee's July 12, 1995 hearings regarding the Federal Pell Grant Program. We appreciate the opportunity to provide our views regarding topics covered by these questions, and would be pleased to provide further information or assistance to your regarding these or other issues under consideration by the Subcommittee.

We hope this information is helpful.

Sincerely,

John P. Higgins, Jr.

400 MARYLAND AVE., S.W. WASHINGTON, D.C. 20202-1510

1. **During your testimony on July 12, you stated that "the statutory purpose of preparing students for gainful employment in a recognized occupation could be better accomplished and limited Federal vocational training funds more effectively used if the current funding system were fundamentally changed." What fundamental changes would you recommend? Do you believe that the Pell Grant program is the proper vehicle for funding vocational training? What is your reaction to Dr. Longanecker's approach as outlined during his testimony?**

Work that we performed in 1993 concerning the usefulness of Title IV vocational training resulted in the recommendation that the funding approach for such training be modified to take into account labor market needs and the performance of schools in graduating and placing students. Because school performance and labor market needs are not currently considered, schools can and often do promise prospective students high-paying jobs while providing low-quality training for jobs that do not exist.

Some legislative changes have been made recently to address the lack of performance measures in Title IV programs, but these are not working. The 1992 reauthorization of the Higher Education Act required that accrediting agencies and State Postsecondary Review Entities (SPRE's) consider graduation and placement rates in their evaluation of Title IV-funded vocational training programs. Our review of 5 accrediting agencies, which accredit schools providing vocational training, found the agencies were not holding schools accountable for meeting performance measures. Further, the amendments required that schools offering a program of less than 600 hours graduate at least 70 percent and place at least 70 percent of their students in order to be eligible for Title IV participation. Unfortunately, the SPRE program has gone unfunded, and the Department has not enforced the new requirements on accrediting agencies.

The Department is currently exploring several ideas that would institute performance measures into Title IV funding for vocational training. One such idea is to seek legislative change making the 70/70 rule applicable to all vocational training funded under Title IV. This change, if implemented, would ensure that vocational training funded under Title IV achieved the purposes for which funding was intended.

A second change we have suggested is that the Department consider requiring schools, as a condition of eligibility for Title IV participation, to submit a labor market analysis showing that jobs are available in the field for which the school provides training. Such a change would provide at least some assurance that jobs will be available for students completing Title IV-funded programs.

Regardless of what funding vehicle is used to provide funds to prepare students for gainful employment, without the fundamental changes discussed above, the taxpayers' investment will remain at risk.

We are currently involved in discussions with the Department to fully develop the gatekeeping concepts presented by Dr. Longanecker during the hearings. While we support the ideas presented regarding differentiating among schools based on their performance, we are concerned that "performance", as described by Dr. Longanecker, includes only the administrative and financial aspects of the schools' operations. We believe that the Department also has a responsibility to ensure the quality of education provided by participating schools and that any redesign of the gatekeeping processes must address this aspect of a school's performance. We are hopeful that our concerns in this area can be addressed as our work with the Department continues.

2. **What is your impression as Inspector General as to the extent to which political pressure is being exerted on oversight matters? Is political pressure compromising program integrity?**

The extent to which political pressure is being exerted on the administration of ED programs is not easily assessed. Clearly, it is the role of members of Congress to represent the interests of their constituents before Federal departments, and this role is and should be frequently exercised. However, when representation extends to the point where a member of Congress suggests that federal program officials vary from the letter or intent of law or regulation to provide special treatment for a grantee or other program participant, such representation becomes inappropriate political pressure.

We have investigated and reported on only one situation where we determined that Department officials were influenced by such political pressure. In a case investigated in 1994, a report of which was provided previously to the Subcommittee, we concluded that a college received substantial consideration in the regulatory process as a result of a Senator's intervention on its behalf, which compromised the Department's gatekeeping process. Further, we concluded that the special treatment afforded the college set a dangerous precedent which undermined the Department's stated commitment to strengthen the gatekeeping practices in the SFA programs.

This second conclusion points to the primary danger that can result from inappropriate political pressure. While undue influence might be exercised in only a single case, special treatment by the Department inevitably will be cited by other program participants seeking relief from program regulations.

While pressure exerted by a member or members of Congress might be viewed as inappropriate, it is ultimately the federal program official who must be held accountable for properly enforcing program laws and regulations. While we have no evidence that political pressure is comprising program integrity to a major extent, the danger of such occurring is always present. The attention continuously given this issue by the Senate

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Permanent Subcommittee on Investigations serves as a strong reminder to ED officials of their responsibility in this area.

3. **In your testimony, you stated that the Department has instituted a corrective action plan in response to your 1993 audit on the effectiveness of the institutional review branches. Has this action plan been effective? Are there qualitative measures which show that schools are being monitored more effectively or that problem schools are more readily identified?**

The Department's corrective action plan designed to improve the institutional review process is now being implemented. While it is too soon to definitively conclude that it has been effective, we have seen improvements and we believe the Department is on the right track. The corrective action plan was aggressive and called for a major redesign of the entire process addressing key functions such as, staffing, training, selection of schools, scope of reviews, statistical sampling, reporting and resolution standards. We have assisted the Department in providing training to the reviewers, designing selection criteria and sampling methodologies. It will probably be another year or two before we see the results of this major effort.

Regarding your second concern, we are not aware of any qualitative measures developed by the Department to show that problem schools are being monitored more effectively or identified. The Department does have quantitative measures to show how their oversight and monitoring of schools has improved. However, many of these quantitative statistics are not truly reflective of the Department's efforts. For example, if a school closed because it went bankrupt, the Department includes this in their statistics to support the effectiveness of their oversight in eliminating a problem school, even though the Department may have had nothing to do with the elimination of the school from the Student Financial Assistance (SFA) programs.

In addition to the example provided above, in our opinion, many of the quantitative statistics that the Department provided in support of its testimony presented before the Subcommittee are questionable, because the Department does not maintain adequate supporting documentation. Also, we agree that qualitative measures are needed to accurately assess the Department's progress in improving its oversight and monitoring of problem schools.

4. **During the Subcommittee's 1990 hearings, the Culinary School of Washington was the subject of a staff study. The owner of the Culinary School, Dr. Barkev Kibarian was subsequently the focus of a criminal investigation by your office. What were the results of that investigation? Please provide a copy of any related report.**

In the fall of 1990, our office opened an investigation relating to the Culinary School of Washington. The investigation was predicated upon findings contained in an OIG inspection report which was provided to the appropriate Department of Education (ED) program officials in May 1990. Our investigation focused on information which indicated that in late 1989, the school submitted a number of Guaranteed Student Loan applications for students bearing the code number for the school's eligible location when those students were actually receiving training at two ineligible locations, one in Richmond, VA and the other in Washington, D.C.

In March 1991, the results of our investigation were presented to the United States Attorney's Office, Alexandria, VA. That Office declined criminal prosecution of the school's owners, Barkev and Mary Ann Kibarian, for obtaining student loans for students attending the ineligible Richmond, VA campus. Subsequently, in July 1993, our Office referred the results of our investigation to ED's Office of the General Counsel (OGC), recommending administrative action for damages under the Program Fraud Civil Remedies Act (PFCRA). As of yet, the OGC has not reached a final decision on our recommended action under the PFCRA. Our investigation remains open, pending a final decision from OGC.

As soon as the OGC declines this case for administrative action under the PFCRA is completed, we will be happy to provide the Subcommittee with a copy of our investigative report.

5. **In 1993, the Subcommittee Staff referred allegations of potential wrongdoing at Savannah School of Art and Design to your Atlanta Regional office. That office subsequently conducted an audit and investigation of the allegations. Please provide copies of these reports or a report of the status of any ongoing inquiries into the operations of the Savannah School of Art and Design.**

In response to a referral from the Subcommittee's staff, OIG investigators interviewed a complainant who alleged that officials at Savannah School of Art and Design were engaging in improper and/or abusive practices relating to the school's general administration of Federal SFA funds and specific use of operating funds which, in his opinion, resulted in financial instability for the school. Subsequently, the complainant provided the OIG with a package of documents, including copies of some of the school's financial records, which allegedly supported his allegations.

OIG investigators spoke with ED program staff about the school's most recent financial statements which showed a purported increase in liabilities. Those concerns, the school's two most recent SFA audit reports, and the complainant's documents were provided to OIG audit staff with an expertise in the areas of financial statements and accounting standards. The auditors determined that the liabilities were secured by real estate investments and that there was no evidence substantiating the alleged improprieties.

OIG investigators also contacted ED's regional program staff. The investigators were informed that the school had undergone two reviews, the most recent of which occurred in February, 1994, and that no substantial findings resulted. No further investigation occurred at that time, given the results of preliminary work which indicated no fraudulent school activity.

In April, 1995, the OIG received another referral from the Subcommittee's staff relating to the school. OIG investigators interviewed the complainant and a former student, who alleged that the school abused its non-profit status, misrepresented instructor qualifications to prospective students, and paid bonuses to admissions department employees for each student who completed a quarter of study. The complainant already had contacted the Internal Revenue Service (IRS) about the non-profit status and he indicated that the IRS did not appear to be interested in pursuing that aspect of the allegations. OIG investigators provided the remaining allegations, which were regulatory in nature, to ED's regional program staff. Subsequently, the program staff informed the OIG that after review of the issues and in light of the recent review they had conducted at the school, they found no basis for further action.

Given the level of scrutiny that the allegations have received by numerous individuals over a two year period, the workload of major cases involving clear-cut fraud, and the lack of staff resources, the OIG plans no further investigative activity into these same allegations.

Senate Permanent Subcommittee
on Investigations
EXHIBIT # 42

UNITED STATES DEPARTMENT OF EDUCATION
OFFICE OF POSTSECONDARY EDUCATION
THE ASSISTANT SECRETARY

JAN 17 1996

Mr. Dan Gelber
Chief Counsel to the Minority
Permanent Subcommittee
on Investigations
Committee on Governmental Affairs
United States Senate
Washington, DC 20510-6250

Dear Mr. Gelber:

This is a response to your follow-up questions from the hearing. In my testimony at the hearing, I mentioned that the Department remains interested in pursuing legislative changes that will significantly enhance our oversight capability. As soon as these proposals have cleared internal Administration review, I will share them with you. In addition, I have enclosed a draft copy of the Department's new proposal for improved oversight in Federal student aid programs. The paper incorporates many of the ideas I proposed at the hearing and is being used as a starting point for discussions with the higher education community.

I hope that this is helpful to you. If we can be of further assistance, please let us know.

Sincerely,

David A. Longanecker

Enclosures

400 MARYLAND AVE., S.W. WASHINGTON, D.C. 20202-5100

1. **Question: During the hearing, you outlined a system for differentiating between short term proprietary vocational schools and non-profit degree-granting institutions. Please, if you are able, provide some of the specifics as to how this new regulatory approach of yours would work? In what ways will you differentiate between for-profit and non-profit institutions and between degree-granting and non-degree granting institutions? You said that your new approach will "recognize high performance" and reward it with reduced regulation." In what ways will you measure performance? What manner will you reduce regulation?**

Answer: Under the Department's proposal for improved oversight in Federal student aid, we would continue to increase our monitoring of institutions that pose significant risks to federal funds while providing regulatory relief to institutions that have consistently demonstrated a very high level of competence in administering Title IV programs.

The Department will engage in regulatory relief on two levels. First, the Department will continue to reinvent its regulations to reduce administrative burden on all institutions where overly restrictive requirements do not improve accountability or protect the federal fiscal interest. For example, the Department streamlined the recertification application and revised the FAFSA form to include all statutorily-required student certifications that were previously on separate forms.

Second, institutions that have consistently demonstrated outstanding administration of Title IV programs and strong financial responsibility would be eligible for additional regulatory relief. Possible criteria for determining that an institution has demonstrated outstanding administration of Title IV programs could include: an unqualified opinion on financial statements; no material findings on compliance audits for the prior five years; demonstrably sound internal controls; low default rates; and a history of successful participation in Title IV programs. Because different accounting standards are applicable to different sectors, the Department would also develop different financial responsibility standards for each sector. Institutions that meet these criteria would be eligible for such regulatory relief as less frequent recertification, less frequent submission of compliance audits, and exemption from certain regulatory requirements such as multiple and delayed disbursement, verification, and entrance and exit counseling.

Because increased regulatory relief would reduce the Departmental resources necessary to monitor institutions posing little risk to federal funds, the Department could more fully focus its resources on institutions that pose greater risk. At-risk institutions might be defined as institutions subjected to a Limitation, Suspension, or Termination action in the past several years; on provisional certification (including all new institutions); on reimbursement; or appealing high default rates. At-risk institutions would be subject to the full set of Department regulations and increased oversight and would receive technical assistance from the Department. Examples of increased regulation and oversight for at-risk institutions that the Department could implement through changes in administrative practices include:

- A higher probability of program reviews;
- At-risk institutions with a history of deficiencies would be subject to termination actions by the Department unless they improve their performance in the administration of Title IV programs to adequate levels within specific time frames;
- At-risk institutions that have had two or three major program review findings, such as failure to adhere to the refund policy or failure to follow ability-to-benefit rules would be terminated from participation in all Title IV programs by the Department;
- New institutions that did not demonstrate good performance would remain on provisional certification for five years rather than for three years as is currently required.

Examples of changes that would require legislation include:

- Requiring a personal financial guarantee against liabilities from the owner of any proprietary institution placed on provisional certification and holding individuals with financial authority and responsibility at proprietary institutions personally liable for an institution's unpaid refunds;
- Holding institutions that unsuccessfully appeal high cohort default rates liable for the default costs and subsidies that are paid by the Department on loans to that school during the appeal process. The Department could also require a school that chooses to receive loans during the appeal process to post surety in an amount sufficient to cover these costs;
- Extending the current requirement that short-term vocational programs graduate and place 70 percent of their students to all nondegree vocational programs; and
- Permitting the Department to establish a new expiration date for a Program Participation Agreement for at-risk institutions and thus require a full application for recertification and enable the Department to make decisions based on current information.

The improved oversight system would also ensure that institutions provide better information about educational programs for students to use in making informed decisions about where to enroll. This information will help ensure that market forces work better to eliminate inadequate institutions and programs from participation in Title IV programs and help students make better decisions.

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The Administration has proposed legislation that would require institutions that offer nondegree programs to report information about these programs and information on the outcomes of previous students to one-stop career centers that would provide this information to prospective students. This information could include completion rates, placement rates, licensure exam pass rates, or the percentage of graduates that meet certain skill standards. Although the specific provisions included in the Administration bill were not passed, the Department will continue to develop and support legislation, including provisions in the two versions of the job training bill now being discussed by the Congress and in the next reauthorization of the Higher Education Act, to improve information on the outcomes of both degree and nondegree programs available to students in order to help them make decisions on where to enroll.

2. **Question: You have stated that your new approach will differentiate between for-profit and non-profit institutions. The Subcommittee's hearings in 1993 showed, and recent information indicates, however, non-profit institutions can also be abusive. Moreover, it would also seem very simple for a school to change its status from for-profit to non-profit and to simply plough through all of its profits into salary and expenses. How will your new approach deal with these possibilities?**

Answer: The Department recognizes that in some states, institutions can easily switch from profit status to non-profit status, or from a non-degree granting institution to a degree-granting institution. We want to ensure that schools do not evade certain regulatory requirements simply by changing their designation. For this reason, we will subject schools that do change from profit to non-profit or from a non-degree granting institution to a degree-granting institution to the same requirements of their previous designation for a certain period of time, perhaps as long as five years. We believe that this would be an effective way to dissuade institutions from changing their designation to avoid regulatory requirements. We may need your help, however. Last month, the Department lost a case in U.S. District Court in Kansas that would have bound a for-profit institution to comply with the 85-15 authority after it changed to non-profit status. The Department is considering whether to appeal that verdict. If it proves that such provisions will not hold up in regulation, we will seek your help and support in obtaining statutory authority.

3. **Question: In his testimony, the Inspector General stated that implementation of the plan to recertify all institutions by 1997, as required by the 1992 Higher Education Act Amendments, did not begin until 1995, and that this will make it difficult for the Department to meet the statutorily imposed deadline. Why did it take the Department so long to begin implementation? Given this late start, will you be able to meet the 1997 deadline?**

Answer: The Department decided to delay implementing the recertification process until our new data system came on-line. The Postsecondary Education Participants System came on-line on March 1, 1995 and includes space for the additional data that is required by the 1992 Amendments to the Higher Education Act. Despite this delayed start, we plan on meeting the 1997 deadline. The next group of recertification notices will go out in January; our work plan projects completion of the project by the 1997 deadline, and we are on-target to accomplishing this plan.

4. **Question: In his testimony, the Inspector General noted, despite the fact that the 1992 Amendments to the Higher Education Act authorized the Secretary to specify the passing score on independently administered tests approved by the Secretary, the Department has yet to publish final regulations implementing this provision. Had such specific passing scores been promulgated, much of IADE's ability to manipulate the Ability-to-Benefit testing process may have been curtailed. Why has it taken the Department so long to implement this provision? When can Congress expect final regulations?**

Answer: On December 1, 1995, the Department issued final regulations on the Ability-to-Benefit provisions. Since the statute was first enacted, the Department has approved independently administered tests and set passing scores through notices in the Federal Register, despite not issuing final regulations. Furthermore, the Ability-to-Benefit statute has changed twice, with the most recent change requiring negotiated rulemaking. In this process, we took time to carefully consider all of the concerns raised in order to develop fair and equitable final regulations. These final regulations strengthen the test approval process and set the passing score at a higher level to better assess the qualifications of those students who are subject to this provision.

92-498 96 – 8

5. **Question: The Inspector General has found that when Pell Grants are used instead of Adult Education programs to fund training in English as a Second Language (ESL), the education is provided by proprietary schools that charge more for a shorter course of study. IADE appears to have taken in a large amount of Pell Grant funds for purported training in ESL. The Inspector General has recommended that the Department ask Congress to eliminate ESL courses from eligibility under the Pell Grant program. What is your position on this recommendation?**

Answer: The Department has engaged in an ongoing dialogue about how to serve ESL students most effectively and has decided not to make any changes to the Federal Pell Grant Program in this area at this time. An August, 1994 audit report by the Department's San Francisco Regional Office of the Inspector General recommended that the Federal Government stop providing Pell Grants for ESL instruction and instead rely on Adult Education programs for these services. The Department questions the validity of this study due to its reliance on an extremely small number of institutions and adult education programs, and due to its apparent lack of understanding and appreciation of the substantial differences in the purposes of adult education funding and student assistance funding. The Department will consider the issue of whether Pell Grants are the best way to provide support for ESL students in the next reauthorization of the Higher Education Act.

6. **Question: The Inspector General noted a concern about a loophole in the provision prohibiting Pell Grants to prisoners which would allow local and county jail prisoners to continue to receive Pell Grants. How big a problem is this -- how many local prisoners continue to receive Pell Grants and how many schools continue to enroll such prisoners? How many waivers have been granted in recent years? Does the Department see this prisoner loophole as a problem? If so, what does the Department intend to do to address it?**

Answer: The Violent Crime Control and Law Enforcement Act of 1994 amended the Higher Education Act of 1965 by providing that students incarcerated in Federal or State penal institutions are no longer eligible to receive Federal Pell Grants for periods of enrollment that began on or after September 13, 1994. Due to the manner in which the 1994 amendment was drafted, students incarcerated in local penal institutions, such as those operated by city or county governments, remain eligible to receive Federal Pell Grants as long as they meet all other eligibility requirements.

The Department opposed the exclusion of any eligible incarcerated students from the Federal Pell Grant Program due to the positive impact of postsecondary education and training on the rehabilitation of prisoners. However, the Department has complied with and implemented the amendment as enacted.

The 1993-94 award year was the first year in which the Department collected data concerning whether a Federal Pell Grant recipient was an incarcerated student. In that year, almost 43,000, or 1.1 percent of the more than 3.9 million Pell Grant recipients, were incarcerated students. In 1994-95, less than 25,000, or 0.6 percent of the Pell recipients, were incarcerated students. And through November 1995, only 777 of more than two million Pell Grant recipients, during this current award year, were incarcerated students.

As the data for 1995 indicate, a very small number of incarcerated students continue to receive Pell Grants, which indicates that this does not present a substantial policy issue.

7. **Question: The Inspector General has stated that he is doubtful that there will be any meaningful reform in the accreditation process despite the statutory mandate for accrediting standards because the accrediting agencies are reluctant to use performance data to assess the effectiveness of the job training programs they accredit. He recommends Congress consider legislating appropriate performance standards. How do you respond to the Inspector General's comments in this area?**

Answer: The Inspector General and I disagree on the progress made by accrediting agencies with regard to their evaluation of educational programs through the creation and development of specific standards. We require accrediting agencies to have standards to assess student achievement and outcomes and we are holding them accountable for these standards. We have completed a preliminary analysis of the standards used by the agencies that accredit proprietary institutions and have found that most have moved, or are moving, toward developing quantitative standards for educational outcomes, such as completion and graduation rates, job placement rates, and passing rates on state licensing exams.

We realize that the accrediting agencies have more work to do in this area and we will continue to hold them responsible for ensuring that the institutions that participate in the student financial aid programs are providing quality education and training to their students. In addition, our National Advisory Committee on Institutional Quality and Integrity (NACIQI) is reviewing applications for agency recognition very carefully and is ensuring that agencies are meeting these requirements before they are recognized by the Secretary.

8. **Question: Currently, when a school which is terminated from the student loan program for high default rates it is still eligible to participate in the Pell Grant program. Should these schools terminated for high default rates remain eligible to participate in any other Title IV program?**

Answer: An amendment to the House Appropriations bill, introduced and passed on August 3, would terminate institutions from the Federal Pell Grant Program if they had already been terminated from the student loan program because of high default rates. The Department does not oppose this amendment, but is concerned about possible consequences for institutions with default rates between 25 and 40 percent that have very few student loan recipients. A high default rate for an institution with a small number of borrowers could eliminate unfairly Pell Grants for a substantial portion of the student population. This situation is most likely to occur at community colleges where borrowing rates are very low but participation in the Pell Grant program is much higher.

To adjust for this situation, institutions with high default rates could continue loan eligibility, and thus Pell Grant eligibility, if they meet one of the specified mitigating circumstances. On December 1, 1995, the Department issued final regulations to revise the definition of mitigating circumstances. Specifically, if the institution's cohort default rate multiplied by the percentage its enrolled students receiving a student loan results in a product less than or equal to 0.0375 over a definite time period, the institution would not be terminated from the student loan program, and would remain eligible for the Pell Grant program.

Discussion Draft

Proposal for Improved Oversight in Federal Student Aid

U.S. Department of Education
November 1995

Discussion draft
11/29/95

The Department of Education is proposing enhancements to its system of monitoring and oversight of institutions that are participating in Title IV student financial aid programs. Under this proposal, the Department would continue to increase its oversight of institutions that pose significant risks to federal funds and of new institutions, because they may experience problems in administering federal programs. The Department would also provide regulatory relief to institutions that have consistently demonstrated a very high level of performance in administering Title IV programs. Because increased regulatory relief would reduce the Departmental resources necessary to monitor institutions posing little risk to federal funds, the Department could more fully focus its resources on institutions that pose greater risk. This proposal builds upon regulatory relief efforts and increased efforts to monitor and oversee at-risk institutions that are already underway in the Department.

The Department will use this proposal as a starting point for discussions with Congress and the higher education community on the role of the federal government in managing Title IV programs and providing better information to students. The Department requests comments and suggestions on this proposal and other ideas for improving the system of oversight of federal student aid programs. The Department will work closely with the higher education community to develop the specifics of the proposal, including administrative and financial performance criteria to identify institutions eligible for regulatory relief and institutions needing increased oversight and support.

Regulatory Relief:

The Department will engage in regulatory relief on two levels. First, the Department will continue to reinvent its regulations to reduce administrative and paperwork burden on all institutions where overly restrictive requirements do not improve accountability or protect the federal fiscal interest. For example, the Department streamlined the recertification application, revised the FAFSA form to include all statutorily-required student certifications that were previously on separate forms, and is developing a less complex refund policy for all institutions. (Statutory changes will be necessary to simplify the refund policy to the extent desired.)

Second, under this proposal, institutions that have consistently demonstrated outstanding administration of Title IV programs and strong financial responsibility would be eligible for additional regulatory relief. Possible criteria for determining that an institution has demonstrated outstanding administration of Title IV programs could include: an unqualified opinion on financial statements; no material findings in compliance audits for the prior five years; demonstrably sound internal controls; low default rates (adjustments would be made for institutions with a small percentage of students borrowing); a history of successful participation in Title IV programs; full unqualified certification; and absence of any adverse actions by accrediting agencies during the institutions' last two full accreditation reviews. The Department

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would also develop different financial responsibility standards for different sectors. Because different accounting standards are applicable to different sectors, financial statements are not consistent across all sectors. The Department will develop financial indicators which, although different, nevertheless measure the same aspect of financial health across all three sectors.

Institutions that meet these criteria for strong administrative and financial performance would be eligible for such regulatory relief as less frequent recertification, less frequent submission of compliance audits, and exemption from certain regulatory requirements (such as multiple and delayed disbursement, verification, and entrance and exit counseling requirements). A significant percentage of the departmental resources currently used to oversee and monitor the requirements for strong institutions would be used to focus more resources on at-risk institutions.

Institutions that do not meet all of the criteria for strong Title IV management would still be able to apply for selective regulatory relief through the Quality Assurance (QA) Program. Under the QA program, institutions that voluntarily demonstrate that they meet certain criteria related to their management of Title IV programs would be eligible to request specific regulatory relief tied to their administrative performance. For example, institutions voluntarily documenting low default rates would be eligible to develop their own exit and entrance counseling requirements. As institutions improve their performance in Title IV programs, they could become eligible for additional regulatory relief. The Department is already starting to provide this case-by-case regulatory relief under the experimental sites authority.

Several of the proposals would require statutory changes in Title IV of the Higher Education Act (HEA). Because it is unlikely that legislative changes could be made before the next reauthorization of the HEA, the Department proposes to expand its use of its experimental sites authority to provide statutory and regulatory waivers.

Increased Monitoring and Oversight of At-Risk Institutions:

The Department would increase monitoring and oversight for at-risk institutions. At-risk institutions might be defined as institutions subjected to a Limitation, Suspension, or Termination action in the past several years; on provisional certification (including all new institutions); on reimbursement; or appealing high default rates. At-risk institutions would be subject to the full set of Department regulations and increased oversight and would receive increased technical assistance from the Department. Examples of increased regulation and oversight for at-risk institutions that the Department could implement through changes in administrative practices include:

- A higher probability of program reviews by the Department;

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- At-risk institutions with a history of deficiencies would be subject to termination actions by the Department unless they improve their performance in the administration of Title IV programs to adequate levels within specific time frames;

- At-risk institutions that have had two or three major program review findings, such as failure to implement satisfactory progress standards, failure to adhere to the refund policy, or failure to follow ability-to-benefit rules, would be terminated from participation in all Title IV programs by the Department; and

- New institutions that did not demonstrate good performance would remain on provisional certification for five years rather than for three years as is currently required.

Examples of changes that would require legislation include:

- Requiring a personal financial guarantee against liabilities from the owner of any proprietary institution placed on provisional certification and holding individuals with financial authority and responsibility at proprietary institutions personally liable for an institution's unpaid refunds;

- Holding institutions that unsuccessfully appeal high cohort default rates liable for the default costs and subsidies that are paid by the Department on loans to that school during the appeal process. The Department could also require a school that chooses to receive loans during the appeal process to post surety in an amount sufficient to cover these costs;

- Extending the current requirement that short-term vocational programs graduate and place 70 percent of their students to all nondegree vocational programs; and

- Permitting the Department to establish a new expiration date for a Program Participation Agreement for at-risk institutions and thus require a full application for recertification and enable the Department to make decisions based on current information.

To help identify institutions needing more oversight, the Department is developing a system of risk analysis that will enable the Department to better select institutions for examination of compliance and concentrate resources on institutions with potentially serious problems. Making this system viable will require improvement of information in the Department's data bases such as the National Student Loan Data System, the full development of

the Postsecondary Education Participants System, and the development of good tracking systems. The Department is taking steps to increase data integrity and is committed to providing the systems required.

To better implement oversight of at-risk institutions, the Department is moving toward a new approach of monitoring institutional performance in Title IV programs. Currently, the Department reviews institutional performance through four largely independent processes -- recertification, analysis of financial statements, review of compliance audits, and program review. While recertification requires some cross analysis of these different areas, the system does not otherwise facilitate decisions based on the total information the Department may have concerning an institution. The new system will use case management as the central core process and will enable decision making based on all information concerning a school which may be relevant to Title IV compliance, including information supplied by outside entities such as accrediting agencies.

Student Information:

The improved oversight system would also ensure that institutions provide better information about educational programs for students to use in making informed decisions about where to enroll. This information will help ensure that market forces work better to eliminate inadequate institutions and programs from participation in Title IV programs and help students make better decisions.

Under the Student Right to Know Act, all institutions must make available their completion and graduation rates in their catalogs or other material readily available to all prospective students requesting this information. The provision of graduation rates should allow prospective students to consider the likelihood of completing at a specific institution, the potential benefit they would derive from the time and money needed to invest in a program, and whether they would be more likely to benefit at another school. Final regulations to implement the Student Right to Know Act will be published December 1st. These regulations require institutions to begin disclosing completion and graduation rates for students who enter the institution after July 1, 1996. Completion and graduation rates will be calculated for full-time, undergraduate certificate- or degree-seeking students.

In addition to information required under the Student Right to Know Act, the Administration has proposed legislation that would require institutions that offer nondegree programs to report information about these programs and information on the outcomes of previous students to one-stop career centers that would provide this information to prospective students. This information could include completion rates, placement rates, licensure exam pass rates, or the percentage of graduates that meet certain skill standards. Although the specific

provisions included in the Administration bill were not passed, the two versions of the job training bill now being discussed by the Congress include related provisions.

- Under the bill passed by the House, states would require institutions that offer nondegree job training to submit certain performance-based information to the state before the institution could become eligible to receive federal funds for job training programs. This information would be made available to prospective students through integrated career centers.

- The job training bill passed by the Senate creates career centers for distribution of information to prospective students, but does not specify how the career centers will obtain information from institutions.

The Department will continue to develop and support legislation to improve information on the outcomes of both degree and nondegree programs available to students attending institutions participating in the Title IV student aid programs. The Department plans to continue this focus in specific proposals included in the next reauthorization of the HEA.

Senate Permanent Subcommittee on Investigations
EXHIBIT # 43
JUL 18 1995

GEORGIA STATE POSTSECONDARY REVIEW ENTITY

A Unit of the Nonpublic Postsecondary Education Commission

Zell Miller
GOVERNOR

William C. Mangum, Jr.
DIRECTOR

Ross Miller
SPRE ADMINISTRATOR

M-E-M-O-R-A-N-D-U-M

DATE: July 12, 1995

TO: Permanent Subcommittee on Investigations of the Committee on Governmental Affairs, United State Senate

FROM: Ross Miller
SPRE Administrator

RE: Administration of Title IV, Higher Education Act with particular reference to Pell Grants and the State Postsecondary Review Program

---

Access of an institution and its students to Pell grants generally follows the procedures your subcommittee described as applicable to the Guaranteed Student Loan Program in its Report 102-58 dated May 17, 1991. Some revisions and additions were incorporated in the Higher Education Act amendments of 1992.

In Georgia, Pell grants are enabling many students to have access to postsecondary education who could not otherwise assemble adequate financial resources, and many lives have improved through this assistance. Nevertheless, some of the postsecondary programs are not serving the students well. This office observes several problems. Sometimes an institution will admit a student who is unlikely to successfully complete the program and enter the job market. Sometimes an institution offers a weak program. Sometimes an institution does not provide adequate services (i.e., placement, counseling). And, in many cases, economically disadvantaged citizens are left with overpowering debts because their tuition for job training in low-paying occupations was inflated to make them eligible for full Pell grants. (Thus, they signed for a complementary loan for every grant received.)

Also, states vary in licensing requirements. A plan to strengthen state oversight of institutions administering Title IV funds was described as the State Postsecondary Review Program. This program has already had some positive effects. It is my belief that strengthening the role of the states in oversight will lead to a reduction of fraud and abuse in Pell grants as well as in other Title IV financial aid programs.

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(404) 414-3307 • FAX (404) 414-3309

Senate Permanent Subcommittee on Investigations
EXHIBIT # 44

PATRICIA STEVENS COLLEGE

July 8, 1995

The Honorable William V. Roth, Jr.
United States Senate
193 Russell Senate Building
Washington, D.C. 20510

Dear Senator Roth:

As Chairperson of the Commision for Postsecondary Schools Accreditation of the Accrediting Council for Independent Colleges and Schools, I have a similar sense of frustration as expressed in your release of July 6, 1995.

For a number of years, our body has been pursuing an objective tool for evaluating the quality of proprietary education which would assist in eliminating the abuse at issue. Traditionally, the focus of such evaluation has relied primarily on institutional default rates. As the Executive Director of an institution with a history of single digit default rates it would be quite simple to leave the issue alone; however, my 35 years of industry experience and my six years as a commissioner make it very clear that an objective evaluation of education must include a focus on the following:

a. Job Placement Rate
b. Retention/Graduation Rate
c. Default Rate
d. Socio-economic Background of Student Population

with appropriate adjustments including urban employment rate and program length.

Enclosed is a copy of a proposed IQE which would clearly provide a means for contrasting quality programs with those of inferior performance and thus provide an appropriate instrument for weeding out those institutions that fail to perform. I anticipate moving the adoption of the index with necessary revisions at the August meeting of our Commssion. The Index has been shared with Marianne Phelps at DOE and with Congressmen Andrews, D-NJ, Costello, D-IL, and Talent, R-MO.

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Letter, Senator Roth, July 8, 1995, p. 2

In closing, it is critical that you understand the deep concern that the majority of us within the proprietary industry have about the nature of this abuse and of our willingness to assist you and others in bringing it to an abrupt end.

Respectfully,

Richard R. Harvey,
Executive Director

Enclosure

INSTITUTIONAL QUALITY INDEX

Background

For many years, various agencies have sought to evlauate the quality of proprietary education using the singular measure of default rates as the basis for determining educational quality.

The Department of Education (DOE) has further challenged the accreditation process as a qualitative means of evaluating education both openly (by reducing recognition length to three years and by requiring agencies to provide technical assistance to member institutions via Default Management Programs) and internally as expressed during meetings with Commissioners and Department representatives.

ACICS has, over the years, sought to identify objective data that may indicate when an institution is providing quality education. Typically, issues such as retention, placement, as well as default rates, and socio-economic background of students have evolved as realistic tools for measuring institutional effectiveness.

Most recently, Representative Rob Andrews (D-NJ) has proposed the "Quality Educational Index Act" (H.R. 4384) to replace the current measure of cohort default rates.

As a result of the above background plus the results of numerous studies which clearly demonstrate that socio-economic backgrounds of students, length of programs, and urban employment rates affect institutional outcomes, the cohort default issue is not a realistic means in itself of evaluating educational quality. It appears today, that this Council has a unique opportunity to develop an index which could objectively identify:

a. Institutions providing quality educational programs
b. Institutions needing to strengthen educational delivery

and further:

c. Provide a means of developing incentives to reward quality institutions
d. Provide insight for the development of technical assistance and training to strengthen those institutions of marginal quality

Assumptions

The development of a formula for indexing institutions appears to focus on the following areas:

a. Job Placement Rate
b. Retention/Graduation Rate
c. Default Rate
d. Pell Eligibility Rate of Students Served

and further:

e. Urban Employment Rate

(1)

Formulas

An initial draft of a formula, authored by ACICS Counsel William Clohan, in conjunction with current COPSA Chair Richard R. Harvey, follows:

Institutional Quality Index (IQI)=

2 (retention rate) + 2 (placement rate) +(100 - default rate)

with the following adjustments:

Retention Rate: the calculation of the Adjusted Retention Rate (AdRR) is as follows:

> "For every percentage of the entire student body represented by an economically disadvantaged student, the actual retention rate would be adjusted by two-tenths of one percent. Then, the resultant number would be multiplied by the factor based on the length (LP) in academic years."

Length of Program	Factor
LP <1	1
LP= 1	1
1 <LP</=2	1.2
2 <LP</=3	1.4
3 <LP</=4	1.6

For example, if a two year program had 30% of its students enrolled with ZEFC (zero expected family contribution) and it had an actual retention rate of 66%, then the AdRR would be 86.

AdRR= 1.2[AcRR] + .2(ZEFC) = 1.2[66 + .2(30)]= 1.2[72]= 86

Placement Rate: the calculation of the adjusted placement rate (AdPR) is as follows:

> "for every one-half of one percent the unemployment rate in the service area exceeds full employment (the marginal unemployment rate or MUR) for that area as defined by the U.S. Department of Labor, the Actual Placement Rate(AcPR) will be increased by one percent."

For example, if the AcPR is 70% and the unemployment rate exceeds full employment by 4%, then the AdPR is 78.

AdPR= AcPR + MUR/.5= 70 + 4/.5= 70 + 8 =78

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Default Rate: the calculation of the Adjusted Default Rate (AdDR) is as follows:

> "For every percentage of the entire student body represented by an economically disadvantaged student, the actual default rate (AcDR) would be adjusted downward by two-tenths of one percent.
>
> An economically disadvantaged student is defined as one who has a zero expected family contribution(ZEFC)."

For example, if an institution had 30% of its students with zero EFCs and had an actual default rate of (AcDR) of 30%, the institution's adjusted default rate (AdDR) would be 24.

AdDR= AcDR - .2(ZEFCR) = 30 - .2(30) = 30 - 6 = 24

Summary of Example:

The IQI would then be calculated as follows:

IQI= 2 x AdRR + 2 x AdPR + AdDR

2(86) + 2(78) + (100-24)= 172 +156 +76= 404

Ratings:

Absolute Ratings:

430 and above= substantially exceeds minimum standards; exempt from many accreditation criteria and reporting requirements; probable extended grant of accreditation.

385-429= exceeds minimum standards; exempt from some accreditation criteria and reporting requirements; possible extended grant of accreditation.

340-384= meets minimum standards; treated within standard criteria and grant process.

295-339= below minimum standards; possible deferral or showcause.

295 and below: substantially below minimum standards; subject to showcause or suspension.

Relative Ratings:

Instead of the absolute scale above, ACICS may want to use standard deviation analysis to determine incentives for positive performance or a need for special review. Since factors that have a significant impact on the results have already been provided for, it is now possible to compare institutions in one grouping instead of segregating the institutions

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ANDREWS FORMULA

The initial proposal of Representative Andrews (D-NJ) (as described in the November, 1994 issue of the Career College Times is as follows: (if interpreted correctly)

Job Placement Rate(JPR) + Pell Eligibility Rate(PER) + Cohort

Default Rate(CDR) + Graduation/Licensure Rate(GLR)= Quality

Educational Index(QEI), weighted as follows:

JPR x 37.5% + PER x 25% + CDR x 25% + GLR x 12.5%= QEI

thus an institution with a JPR=90%, PER=50%, CDR=8%, and GLR=85%

would attain a QEI of 79.88.

That is: (90 x .375) + (50 x .25) + (92 x.25) + (85 x .125)=

33.75 + 12.5 + 23 + 10.63= 79.88

It appears that by using ACICS AIR data, a relative scale using standard deviation analysis could be most effective.

Example: ACICS industry average using above formula= 68.20, institutions +12 points substantially exceed minimum standards and could anticpate incentives similar to absolute scale previously described.

Institutions -12 points, not meeting minimum standards, subject to appropriate action(s).

Questions?

1. Are appropriate adjustments built into Andrews formula?

2. Does Graduation/Licensure Rate equate to Retention Rate?

SUMMARY

- # Retention rates are affected by socio-economic background of student population and by length of program.
- # Placement rates are affected by unemployment rate in geographic region served by instiution.
- # Default rates are affected by socio-economic background of student population.

Any formula that drives a consideration or action by ACICS should account for these factors.

(4)

DATABASE

Only as accurate as information submitted by institutions.

Formula should include public information to be valid in eyes of DOE or other agencies.

Subject to audit prior to giving considerations.

Formula for internal Council use only or to be revealed to field?

AUDIT PERIODS/ACTIONS

1. Following review of AIR, letter directed to institution advising of level of accreditation.

2. 3 year period prior to year of grant expiration, if willing to audit AIR data and not on financial review, probable extension of grant without self study/scheduled visit.

3. Two consecutive AIR's placing in lower index could trigger action.

IMPLEMENTATION

1. Following final review, a motion will be placed before the Council at the August meeting to phase in IQI in Fall, 1995.
   - Step 1: Adopt formula, apply to 1995 AIRs
   - Step 2: Structure index using both absolute and relative methods of analysis
   - Step 3: Institutions substantially exceeding criteria via both methods of analysis will be advised accordingly and recognized at 1996 Annual Meeting?
   - Step 4: Review process in August, 1996 meeting including review of Team Reports of those institutions recognized by process and who have had visits during the cycle.
   - Step 5: Implement changes as necessary including communication to institutions with less than minimal performance.

   Note: annual review thereafter is assumed.

2. Assuming evolvement of IQE moves as scheduled, implement possible extension of grant for institutions with positive indexes for years 1995, 1996, and 1997. Institutions with grants expiring 12/31/98 would, thus, become first group eligible under program.

(5)

Senate Permanent Subcommittee on Investigations
EXHIBIT # 46

IADE AMERICAN SCHOOLS
CORPORATE OFFICE: 880 W. WASHINGTON BLVD., LOS ANGELES, CA 90015
PHONE: (213) 748-6066 FAX: (213) 748-6081

October 6, 1993

Geneva Cromie, Acting Chief
Default Management Section
United States Department of Education
ROB - 3; Room # 3919
400 Maryland Ave., S.W.
Washington, DC 20202-5353

Re: Voluntary Withdrawal from FFEL Programs of IADE American Schools; School ID: 026088

Default Management Section:

This correspondence serves as a formal request by IADE American Schools (School ID: 026088) that we be allowed to voluntarily withdraw permanently from all Federal Family Education Loan Programs effective immediately. Given that this institution's current 1991 Cohort default rate is 44.6 percent and was not reduced by 5 percentage points from our FY 1990 rate, we are well aware that the Department could in the future elect to initiate an administrative action to limit, suspend or terminate (LS&T) our eligibility to participate in Title IV aid programs. While we are, of course, hopeful that our official withdrawal from the FFEL programs will alleviate the need for any such action, IADE, in all candor, did not withdraw from FFELP because of our FY 1991 cohort default rate. In fact, IADE has, in actuality, already discontinued certifying ALL FFELP loans more than a year ago well before the FY 1991 rates had been issued. In addition, we had begun a dramatic reduction in the number of loans certified well before we received our first set of cohort default statistics for FY 1990. While IADE realizes that our voluntary withdrawal from the FFEL Programs does not automatically preclude the Department from pursuing future administrative action relative to other Title IV aid programs, we believe the following factors clearly indicate that such action would be unwarranted. Please consider each of the following factors:

1. IADE had voluntarily discontinued certifying ALL Federal SLS Loans and significantly curtailed Federal Stafford Loan certification on April 21, 1992 and discontinued participation in ALL Family Federal Education Loan Programs-FFELP programs on September 16, 1992. During this period in 1992 IADE voluntarily went from certify an average of 40 student loans per month to the following certification rates: 5/92 = 15 loans, 6/92 = 4 loans, 7/92 = no loans, 8/92 = 5 loans and 9/92 = 4 loans. As previously indicated, not a single Federal Family Education Loan has been certified by IADE since September, 1992. Upon assuming the position as Corporate Director of Financial Assistance for IADE American Schools in December of 1991, Ken Williams, Jr. became concerned that a number of factors associated with IADE's student population, could, despite our best default prevention efforts, e.g., IADE voluntarily implemented "Appendix D" prior to being required to do so, make management of student loan defaults extremely difficult, if not impossible. Consequently, IADE decided to begin a dramatic reduction in the number of loans certified starting in April of 1992 and ultimately to voluntarily discontinue participation in all FFEL programs. This participation ended in September of 1992. The last loan guaranteed for this institution, according to official California Student Aid Commission (CSAC) records, was on September 16, 1992. If it so chooses, the Department may confirm this fact, and other CSAC data presented in this letter, with Ms. Michele Walker, Program Analyst for CSAC. She may be reached at (916) 323-9842.

2. IADE did not become eligible to participate in Title IV aid programs until August 14, 1989 and did not begin certifying student loans until October of the same year. As such, IADE did not receive its first cohort default rate data from the Department until July 6, 1992 when it receive the FY 1990 cohort data. This initial default rate notice confirmed the concerns we had already identified. Keeping in mind that we began reducing FFEL participation on April 21, 1992 and had done only four loans in the month preceding the Department having issued IADE's first set of cohort data on July 6, 1992, it is clearly evident that IADE's

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IADE AMERICAN SCHOOLS
CORPORATE OFFICE: 550 W. WASHINGTON BLVD., LOS ANGELES, CA 90015
PHONE: (213) 748-5500 FAX: (213) 748-5001

decision to reduce and subsequently discontinue all participation in the Federal Family Education Loan Programs resulted from internal policy concerns and our desire to avoid saddling students with unnecessary loan debt rather than as a result of any pressure from the Department of Education to do so.

3. Ken Williams, Jr., IADE's Corporate Director of Student Financial Assistance is the former head of training for the California Student Aid Commission's Division of School Services. In that capacity Mr. Williams served as the chief training officer for the more than 800 postsecondary institutions participating in the Part B Loan programs. Mr. Williams is recognized as a national expert on student loan defaults and has repeatedly presented on the topic for such organizations as the National Council of Higher Education Loan Programs (NCHELP), the Western Regional Association of Student Financial Aid Administrators (WASFAA) and the California Association of Student Financial Aid Administrators (CASFAA). Mr. Williams' credentials make it clear that IADE made every conceivable effort to curb its institutional default rate, even spotting the problem before it was brought to our attention by the Department for the first time on July 6, 1992. As such, there is little evidence to suggest the existence weakness in this institution's management of the FFELP or other Title IV aid programs which would warrant Departmental administrative action.

4. As we had voluntarily discontinued all participation in September of 1992 and knew we would not be certifying additional loans, we originally saw no need to officially notify the Department to remove the Part B Loan Programs from IADE's list of eligible Title IV programs. However, in effort to confirm to the Department that our withdrawal was, and is, both sincere and permanent, we have elected to do so officially at this time.

Despite having withdrawn from the FFEL Programs, IADE will, of course, continue to work with the Department, state guaranty agencies, lenders, servicers and secondary markets in assisting in skip tracing and other efforts designed to protect the integrity of Federal Family Education Loan Programs. Again, while IADE acknowledges the fact that our withdrawal from FFEL programs does not preclude the department from taking future administrative action as relates to other Title IV aid programs, I believe the factors outlined above would clearly not warrant such action. Should you, however, have questions or desire additional documentation, please feel free to contact either myself or IADE's Director of Student Financial Assistance, Mr. Ken Williams, Jr. Thank you for your consideration.

Sincerely,

Abraham Hofmacher,
President

cc: Institutional Participation Division, USDE
California Student Aid Commission

ACCET

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STATE OF CALIFORNIA — PETE WILSON, Governor

COUNCIL FOR PRIVATE POSTSECONDARY
AND VOCATIONAL EDUCATION
1027 10th Street, Fourth Floor
Sacramento, CA 95814

Senate Permanent Subcommittee
on Investigations
EXHIBIT # 54

June 5, 1995

CORRECTED COPY

Dan Gelber
Chief Counsel to the Minority
Permanent Subcommittee
on Investigations
United States Senate
Committee on Governmental Affairs
Washington, DC 20510-6250

Dear Mr. Gelber:

Thank you for the opportunity to comment on the closure of IADE American Schools and the impact of the closure on federal financial aid programs.

Impact of School Closures on the STRF

California maintains a Student Tuition Recovery Fund (STRF) for residents who have suffered a loss as a result of the untimely closure of a school or breach of contract, including the failure to pay a refund.

Since January 1992, $611,842.00 has been paid to students who attended schools participating in Title IV programs. A list of the forty schools for which STRF claims were paid is attached.

Summary of the review of IADE American Schools

Attached is a summary of the Audit report for IADE American Schools. Based on the IADE audit, and others, we offer the following observations:

1. For ESL programs, the federal requirements for documenting prior knowledge, training or skills are inadequate.

   This was the most common area of noncompliance in our seventeen audits of schools receiving Pell grants for ESL instruction.

2. Under the current federal financial aid system the only way to determine that refunds are being calculated correctly is through an audit. Schools should be required to submit refund information electronically to test refund calculations for accuracy.

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3. There is little verification that refunds are actually returned to the lender.

   In 1993, California amended the STRF to reimburse students when schools have failed to pay refunds to lenders. It is common that schools pending closure will stop paying refunds to lenders.

4. Schools suspected of fraud and abuse should be placed on reimbursement, pending their resolution of outstanding audit issues.

I hope this responds to your request for information. If I can be of further assistance, feel free to telephone me at (916) 327-2215.

Sincerely,

Les Cochran
Manager
Consumer and Student Protection

Encls.

Financial Impact of School Closures on the Student Tuition Recovery Fund Since 1992

12-May-95

School	Amount
ADRIANS BEAUTY COLLEGE	$695.00
AL TATE BEAUTY COLLEGE	$3,170.00
ALAMEDA TECHNICAL COLLEGE	$3,032.00
AMERICAN BUSINESS INSTITUTE	$7,090.00
AMERITECH-BAKERSFIELD	$3,937.00
AMS COLLEGE	$1,596.00
ANJONS SCHOOL OF COSMETOLOGY	$2,552.00
BETA TECHNICAL SCHOOL	$29,430.00
BROOKLINE TECH	$8,308.00
CAREER DEVELOPEMENT INST	$51,287.00
CAREERCOM	$7,173.00
COLUMBIA SCH BROADCASTING	$9,611.00
GOLDEN STATE COLLEGE	$10,622.00
GRACE BEAUTY SCHOOL	$500.00
GROVE SCHOOL OF MUSIC	$189,645.00
HISER	$22,355.00
INST OF AUDIO VIDEO ENGINEERIN	$20,517.00
LAWTON BUSINESS COLEGE	$7,165.00
MARINELLO BEAUTY SCHOOL	$5,177.00
MIDLAND CAREER INSTITUTE	$7,264.00
NAT'L TECHNICAL SCHOOL	$16,545.00
NATIONAL BROADCASTING	$19,355.00

School	Amount
NATIONAL CAREER COLLEGE	$1,586.00
NATIONAL TECHNICAL COLLEGE	$16,545.00
OAKLAND COLLEGE COURT REPORTIN	$10,677.00
OXNARD BEAUTY COLLEGE	$10,017.00
PACIFIC BEAUTY COLLEGE	$653.00
PACIFIC COAST COLLEGE	$73,696.00 *
PATRICIA STEVENS CAREER COLL	$1,207.00
SOUTHWEST COLLEGE	$5,622.00 *
STUDIO 7 FASION CAREER COLLEGE	$7,503.00 *
THE CAREER INSTITUTE	$5,120.00
TRANSWESTERN	$2,550.00
UNIFIED SCHOOL OF AMERICA	$10,458.00 *
UNILEX COLLEGE	$905.00
UNIVERSAL BEAUTY ACADEMY	$989.00
UNIVERSITY OF SOUND ARTS	$14,483.00
USA UNIFIED SCHOOLS OF AMERICA	$3,185.00
VAN NUYS COLLEGE OF BUSINESS	$3,185.00 *
WILSHIRE COMPUTER COLLEGE	$17,435.00 *
	$611,842.00

*School closure not financially related.

IADE AMERICAN SCHOOLS

The audit staff of the Council for Private Postsecondary and Vocational Education conducted two on-site audits of IADE American Schools. The following is a summary of the areas found to be out of compliance with the statutory requirements of the California Education Code:

AUDIT VISIT MAY 12-14, 1993
IADE AUDIT REPORT ISSUED SEPTEMBER 8, 1993

REVIEW SUMMARY:

1. The Notice of Student Rights was not posted in the classrooms at the El Monte campus; CEC Section 94316.20(b)(c)

2. The student was not provided books for the ESL course in a timely fashion; CEC Section 94319.6(c)

3. Completion and Placement disclosure were incorrect; CEC Section 94316.10(2)(A)

4. ESL instructors lacked Certificates of Authorization and financial aid staff lacked certificates; CEC Section 94311.1

5. The enrollment agreement indicated an additional charge for hours spent beyond the contract length; CEC Section 94316.28(h)

6. Prior knowledge, training, or skills not adequately documented; CEC Section 94316.28(f)

7. The student's record card contained omissions of course work completed; CEC Section 94319.5(2)

8. Discrepant social security number noted on file documents; CEC Section 94319.5(1)

9. Standard of Administrative Capability called into question due to the IRCA Pre-Enrollment Appraisal for Basic English Competency Form 1 Examination being graded incorrectly; CEC Section 94316.28

AUDIT RESPONSE ANALYSIS - INADEQUATE RESPONSES:

1. ESL instructor lacked certifications of authorization -

   The institution requested a waiver for the requirement of three years experience in an approved private postsecondary vocational institution for M^s Sangiovanni; this request was denied because the request violated state law.

2. Inadequate documentation of prior knowledge, training, or skills -

The institution was directed to perform a portfolio review of all students enrolled or who had started classes as of January 1, 1993 to determine whether there was adequate documentation of prior knowledge, training or skills.

In their initial audit response, the institution did not follow the audit requirements. On November 11, 1993, the school was informed that their audit response was unacceptable. They were instructed to perform the review and were provided with a list of criteria specifying the exact documentation the Council would find acceptable for determining prior knowledge, training, or skills. If such documentation could not be located in the student's file, the school was to contact each student and collect the required information. Failure to comply with an item of any student required that the school make a full refund of tuition and all fees to the student's account.

3. The student's academic summary profile sheet contained omission of course work completed -

   The school was required to provide the date the Department of Information Systems completed the system changes made to include all four digits when printing credits earned by the students in the Units 1, 2, 3 and 4.

A response to these outstanding issues was required by the close of business December 15, 1993. The institution failed to respond satisfactorily.

AUDIT VISIT MAY 31 - JUNE 3, 1994
AUDIT REPORT ISSUED AUGUST 29, 1994

REVIEW SUMMARY:

1. The scope of the audit was restricted to several areas because information requested from the institution was either not provided, or was provided in a form other than requested by the auditors. The specific areas impacted were: 1) documentation of prior knowledge, training, or skills, 2) financial responsibility and 3) State pro-rata refunds.

2. The student sample consisted of 100 student files from a list of 2,582 students; the total student population of all IADE schools at the time of audit. This sample was later increased by 10 for a total of 110 student files. Note, the institution failed to include 55 names from the original student list.

3. Inadequate documentation of prior knowledge, training, or skills; CEC Section 94316.28(f) -

   Based on the institution's failure to respond satisfactorily to this issue as addressed in the Council's May 12-14, 1993 audit, an additional review was conducted to determine whether the school had, at a minimum, implemented, and were following, procedures to capture the required documentation.

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Of the 110 student files reviewed, there were 28 files that did not contain any documentation and 13 whose documentation was inadequate. Based on a 37% error rate, the school was instructed, once again, to review its' total student population from January 1, 1993 to the present ensuring that adequate documentation of prior knowledge, training or skills was obtained. For those students whom this documentation could not be obtained, a refund of all tuition and fees paid was required. In addition, the school was instructed to engage in the services of an independent Certified Public Accountant (CPA) to attest to the institution's compliance with this requirement and to the occurrence of the refund payments to student accounts when adequate documentation would not be obtained.

4. Failure to provide financial information, or to provide information in a timely fashion; CEC Section 94316.6; CCR Section 73860(b)(4) -

The scope of the audit was limited by the institutions failure to provide the following requested information:

a. Accounting records for specific financial statement items

b. The trial balance provided for the year ending December 3, 1993 was actually as of January 31, 1994, which the accountant adjusted backwards to the financial statements date. The accountant's work papers regarding the trial balance adjustments were requested, but not provided.

c. Detail relating to an expense item listed on the January 31, 1992 and 1993 Schedule of General & Administrative Expenses totaling $9,993 and $99,335 respectively.

The institution made it clear that they perceived the accounting and financial reporting systems in place to be deficient. A new computerized accounting system was scheduled for full implementation by June 30, 1994, and prior years reviewed financial statements would be reissued by their newly hired accounting firm.

They were required to submit the detailed description of the expense items for the years January 31, 1992 and 1993 of $9,993 and $99,335, respectively.

5. The institution failed to satisfy the financial responsibility requirements; CEC Section 94316.6 -

The institution's current ratio for the year ending January 31, 1993 was 1.02:1, and for the year ending December 31, 1993 it was 1.10:1. This was below the statutory requirement of 1.25:1.

As a result the school was placed on financial quarterly reporting.

6. The institution failed to provide requested information relating to student refunds; CEC 94318.5.

A list of students entitled to refunds for the period of May 14, 1993 to May 31, 1994 was requested. This data was not provided during the on site visit.

The school was required to provide a list of refunds payable as of June 3, 1994. A spreadsheet detailing criteria needed to test the school's compliance and a copy of the front and back of negotiated checks was also required.

7. The institution failed to calculate refunds in accordance with State pro rata requirements; CEC 94318.5.

The school was computing state pro-rata refunds based on a percentage of course completion rather than clock hours. They were instructed to perform a refund reconstruction from January 1, 1993 to the present, applying the correct State pro rata refund formula. Any additional refunds due students as a result of this reconstruction were to be paid and proof of payment submitted. The services of a CPA were to be engaged attesting to the institution's compliance with the State statute.

8. The institution failed to pay refunds in a timely manner; CEC 94318(b).

In 12 of the 18 refund payments reviewed, payment exceeded the 30 days statutory requirement. The institution had indicated in writing that no refunds were due; however, based on information tested, this statement was inaccurate.

9. Pell Grants funds were disbursed prior to the Electronic Student Aid Report Processing date.

There were 8 cases observed where Pell Grant funds were posted to the student's ledger account prior to the U.S. Department of Education's official output document (ESAR) date. This observation was referred to the U.S.D.E.'s Region IX, San Francisco.

10. Pell Grant funds were disbursed without confirmation of citizenship status by the Immigration and Naturalization Service (INS).

There were 3 cases where the ESAR documents indicated that the INS did not confirm the student's statement as an eligible noncitizen and the required documentation from the Department of Justice confirming the student's eligibility status could not be located in the student's file. This observation was referred to the U.S.D.E's Region IX office in San Francisco.

·AUDIT RESPONSE ANALYSIS - INADEQUATE RESPONSES:

The institution's response was dated November 23, 1994.

1. Inadequate documentation of prior knowledge, training or skills.

IADE failed to comply with the required actions stipulated in the audit report.

Specifically, the spreadsheet report was not prepared; the services of a CPA was not engaged; evidence of refund payment to students lacking adequate documentation was not provided. They did, however, state that the portfolio review had been conducted and provided documentation to support their statement. A review of that documentation concluded that, although provided with the guidelines for determining adequate documentation, there was still an error rate exceeding the 10% threshold for non-compliance.

2. The institution failed to pay refunds in a timely manner.

The institution acknowledged their failure to pay refunds within the statutory guidelines (30 days from the date of withdrawal) but stated that due to "unwarranted actions" placing them on reimbursement with the U.S.D.E., there were significant cash flow problems. Consequently, they were frequently forced to choose between meeting faculty and staff payroll, curtailing student services and equipment purchases or returning student aid refunds to the U.S.D.E. They chose to continue providing education to students, planned to pay refunds after the institution had reestablished a normal cash flow.

As such, the institution, while acknowledging their responsibility to promptly refund Title IV funds, continued to place its highest priority on students. Once the Department of Education returned IADE to advance payment status, their cash flow returned to normal and the appropriate refund control procedures are fully reinstated. Their response indicated that refunds were presently being paid on a timely basis, although no such documentation was provided.

3. The institution failed to provide all the documentation requested during the audit.

The institution failed to provide the Council with a list of students entitled to refunds that had not been paid between the period of May 4, 1993 and May 31, 1994.

The required financial statements and related working papers were also not provided. The reviewed financial statements submitted represented a period different from the statements provided during the audit. There was no explanation as to why the actions required in the audit report were not followed.

On October 3, 1994 IADE was granted a 60 day extension to respond to the audit report, and they still failed to perform the required actions.

On January 5, 1995, the Council responded to the additional information provided by IADE. Four audit findings were not resolved in IADE's response:

1. Inadequate documentation of prior knowledge, training or skills.

2. Failure to pay refunds in a timely manner.

3. Failure to provide all documentation requested during the audit.

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4. Failure to satisfy the financial responsibility requirements.

On November 23, 1994 a copy of the Council's audit report and IADE's response was forwarded to the U.S. Department of Education, Region IX.

On January 9, 1995, the Council requested assistance from the Attorney General's Office regarding the institution's failure to respond to pertinent audit issues.

On February 3,1995, prompted by the Council's audit, ACCET performed an unannounced visit to the South Gate campus and issued a Show-Cause directive.

On March 7, 1995, Council representatives attended a meeting sponsored by the U.S. Department of Education. The purpose of the meeting was for the USDOE to gain all available information prior to serving IADE with search warrants and seizing school records.

IADE American Schools ceased instruction and officially closed all California schools on March 13, 1995

ISBN 0-16-052791-0